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3354

No. 20104

United States
COURT OF APPEALS
for the Ninth Circuit

TILLAMOOK CHEESE & DAIRY ASSOCIATION,

Plaintiff-Appellant,

v.

TILLAMOOK COUNTY CREAMERY ASSOCIATION, H. S. DIXON, GAYLORD P. SHIVELY, JOHN S. CRAVEN, JR., OTTO SCHILD and WARREN A. McMINIMEE,

Defendants-Appellees.

APPELLANT'S OPENING BRIEF

Upon Appeal from the Judgment of the United States District Court for the District of Oregon

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JURISDICTIONAL STATEMENT

Tillamook Cheese & Dairy Association, hereinafter referred to as "T. C. & D. A.," brought this action against Tillamook County Creamery Association, hereinafter referred to as "T.C.C.A.," H. S. Dixon, Gaylord P. Shively, John S. Craven, Jr. and Otto Schild, in the District Court for the District of Oregon (R. 1). The first amended complaint added defendant Warren A. McMinimee (R. 92). The second amended complaint (R. 380) states two claims:

Title 15, U. S. Code, by reason of Section 17 of Title 15, U. S. Code, and Section 291 of Title 7, U. S. Code (*Capper-Volstead Act*) (R. 70-71).

Plaintiff filed a motion for injunctive relief under Rules 7(b) and 65 of the Federal Rules of Civil Procedure to which motion plaintiff attached a number of exhibits and the affidavits of George Milne, then president of plaintiff, and of Hans Leuthold, a member of plaintiff's Executive Committee and now president of plaintiff, as well as a copy of the memorandum decision of Judge William G. East which had just been handed down in a case between substantially the same parties[2] (R. 13-38). The parties exchanged memoranda with respect to said motion for injunctive relief (R. 47, 50), and defendants submitted an affidavit of H. S. Dixon, manager of T.C.C.A. and one of the defendants (R. 54), with exhibits attached thereto (R. 61-63). A hearing was held on July 28, 1964, on plaintiff's motion for injunctive relief with testimony given by H. S. Dixon, W. Rogers Higgins, Allen Thomas, George Milne, Basil Tone, Hans Leuthold and Robert M. Kerr (Tr. 36-155). The Court ordered the motion for injunctive relief continued pending disposition of defendants' motion to dismiss (R. 75). After the complaint was dismissed with leave to plaintiff to amend, the Court held the motion for injunctive relief as "presently moot," but under

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[2] This memorandum opinion was followed by findings and conclusions and judgment for T.C. & D.A. against T.C.C.A., was appealed to this Court (No. 19,565) and this Court sustained the judgment below, *Tillamook County Creamery Association* v. *Tillamook Cheese & Dairy Association,* Slip Sheet Opinion April 7, 1965, amended on rehearing (denied) May 20, 1965; 345 F.2d 158.

advisement awaiting plaintiff's proposed amended complaint (R. 103).

Defendants' motion to dismiss was allowed by the Court on grounds cited in the consolidated memorandum decision (R. 85-90), with leave on the part of plaintiff to file an amended complaint

> "joining appropriate additional parties defendant, pursuant to the Federal Rules of Civil Procedure" (R. 91).

Thereupon, plaintiff filed an amended complaint stating two separate claims, joining one additional defendant, Warren A. McMinimee (R. 92).

Its first claim charges the defendants with

> "violations of the anti-trust laws of the United States, by their agreement, combination or conspiracy, among themselves, and with others, in restraint of interstate trade or commerce, and further, by their combination or conspiracy, among themselves, and with other persons, to monopolize a certain part of interstate trade or commerce." (R. 92).

And more specifically:

> "Beginning on or about January 1963, and continuing uninterrupted thereafter up to and including the date of the filing of this amended complaint, the defendants, well knowing the facts herein alleged, have:
>
> 1. Restrained interstate trade or commerce in the production and the marketing of milk, cheese and other dairy products by contracting, combining or conspiring with each other and with Carl H.

Cadenau, of Portland, Oregon, and other persons, and defendant corporation within itself by and through its officers, agents and employees in restraint of such trade or commerce, contrary to Section 1 of the Sherman Act (15 U.S.C.A., Section 1) and;

2. Combined or conspired with each other, and with Carl H. Cadenau, and other persons, to monopolize a certain part of said trade or commerce, contrary to Section 2 of the Sherman Act (15 U.S.C.A., Section 2); (R. 93).[3]

The second claim of the amended complaint sought to recover damages for violation of Section 2 of the Sherman Act by reason of "the attempt of each defendant severally, and also jointly, to monopolize a certain part of interstate trade or commerce" (R. 98).

Following the filing of the amended complaint defendants moved for summary judgment on the ground "that there is no genuine issue as to any material fact and that defendants are entitled to judgment as a matter of law" (R. 108). This motion was based on the pleadings and memorandum decision of the Court of August 6, 1964 (R. 85), attached affidavits of Carl H. Cadonau (R. 110), H. S. Dixon (R. 113) and W. A. McMinimee (R. 117), the attached memorandum of law and oral testimony of Messrs. Cadonau, Dixon and McMinimee "to be presented at the hearing if the Court desires to hear such testimony" (R. 108).

Plaintiff then filed a counter-affidavit of George

[3] Carl H. Cadenau is the general manager of Alpenrose Dairy, Inc. (R. 110).

Milne (R. 139), then president of plaintiff, T.C.&.D.A., and additional memoranda of law in opposition to defendants' motion for summary judgment (R. 263, 307).

Prior to the Court's ruling on defendants' motion for summary judgment, plaintiff filed certain interrogatories to defendant Warren A. McMinimee (R. 143) which were answered in part (R. 298), to defendant Tillamook County Creamery Association (R. 156) which were not answered, to defendant Otto Schild (R. 161), answered in part (R. 316), to defendant Gaylord P. Shively (R. 167), answered in part (R. 321), and to defendant John S. Craven, Jr. (R. 206), answered in part (R. 326). Defendant objected to those interrogatories propounded and not answered; plaintiff later withdrew all those interrogatories without prejudice, pending resolution of the present appeal.

Defendants moved for a protective order "limiting plaintiff's discovery to whether Warren A. McMinimee and Carl Cadonau illegally conspired as outside parties with Tillamook County Creamery Association to injure plaintiff, as alleged in the complaint" (R. 175). Memoranda of law were presented with respect to this motion by defendants (R. 176-205) and by plaintiff (R. 213-262).

Plaintiff also submitted additional affidavits in opposition to defendants' motion for summary judgment, executed by certain officers and members of plaintiff: Hans Leuthold (R. 330), Del Mayer (R. 338), Joe Donaldson (R. 340), Glenn Johnston (R. 343), Floyd Woodward (R. 345), Vern Lucas (R. 346), George

Milne (R. 349), Barbara Milne (R. 362), Clem Hurliman (R. 367), Basil Tone (R. 372), and Evelyn Pallin (R. 374).

Depositions were taken by the plaintiff in Tillamook of some eight witnesses; the depositions of Warren A. McMinimee and Carl H. Cadonau were taken in open Court on November 30, 1964 (R. 377; Tr. 239-306); the Court then entered an order allowing the plaintiff to further amend its complaint by adding Alpenrose, Inc. as "co-conspirator," in lieu of Carl H. Cadonau, its general manager, individually (R. 378).

Plaintiff then filed its second amended complaint by permission of the Court (R. 380). That complaint differed from the first amended complaint only in naming Alpenrose Dairy, Inc., an Oregon corporation, as a "co-conspirator" with respect to violations of the antitrust laws alleged in the first claim of such complaint, alleging injury and claiming damages.

The filing of the second amended complaint was followed by renewed motions by defendants for summary judgment based on the pleadings, affidavits of defendants Dixon, McMinimee and of Carl H. Cadonau, the answers to interrogatories of Warren A. McMinimee, Gaylord Shively, Otto Schild, John Craven, Jr., and the depositions of McMinimee and Cadonau taken before the Court on November 30, 1964 (R. 391; Tr. 239, 268). Defendants also filed a reply memorandum to plaintiff's earlier memoranda and supplemental memoranda (R. 393).

The Court allowed defendants' motion for summary

judgment as to the first claim of the second amended complaint and denied summary judgment as to the second claim (R. 409, 437). Defendant Warren A. McMinimee thereafter filed a motion for summary judgment in his favor as to the second claim of plaintiff's second amended complaint, with respect to him, "on the ground that there is no issue as to any material fact and that he is entitled to judgment as a matter of law" (R. 411).

The Court allowed this motion and granted summary judgment in favor of Warren A. McMinimee as to the second claim of plaintiff's second amended complaint (R. 441-442).

It should be noted that an answer and counterclaim was filed by the defendants, except Warren A. McMinimee (R. 417), and trial by jury was demanded by defendants (R. 431).

Plaintiff appeals from both

(1) Summary judgment in favor of all defendants as to plaintiff's first claim, i.e. alleged violations of the conspiracy provisions of Sections 1 and 2 of the Sherman Act, and

(2) Summary judgment in favor of Warren A. McMinimee as to plaintiff's second claim, i.e. alleged violation of Section 2 of the Sherman Act by an attempt to monopolize.

B. Summary of the Parties' Contentions about Matters of Fact in Dispute.

(1) Plaintiff contends and alleges[4] that defendant T.C.C.A. was during all pertinent times an agent for producers of milk, cheese and other dairy products, engaged in grading and marketing such products at wholesale in interstate trade or commerce [second amended complaint's (first claim) paragraph IV (R. 381), and (second claim) paragraph II (R. 386)].[5]

This is denied by the defendants in their answer and counterclaim (paragraph II(c); R. 418).

(2) Plaintiff contends and alleges, inter alia:

(a) Defendants have arbitrarily denied to the plaintiff, on or about January 16, 1963, its vested right to representation on the Board of Directors of defendant T.C.C.A. and forced plaintiff to terminate its membership in defendant T.C.C.A., which theretofore had been the grading and marketing agent for substantially all of plaintiff's cheese and other dairy products (R. 382, 387);

(b) Defendants have refused to pay over to plaintiff a credit balance due from T.C.C.A. to the plaintiff in the sum of $771,527.06 representing plaintiff's so-called Grade A Milk Account, the further sum of $711,-127.92 representing plaintiff's so-called Cheese Account, and the further sum of about $300,000.00 representing

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[4] The allegations of the complaint were verified by affidavit (R. 33).

[5] All of plaintiff's contentions and allegations are made with respect to both the first and second claims asserted in the second amended complaint, except as hereafter specifically noted.

plaintiff's so-called Feed Department Account (R. 382, 387);

(c) Defendants have intimidated or attempted to intimidate, and threatened a major creditor of the plaintiff, to limit or destroy the availability of loan capital and to destroy plaintiff's line of credit (R. 382, 387);

(d) Defendants have intimidated or attempted to intimidate and induced or attempted to induce plaintiff's suppliers and patrons to refuse to sell to and deal with plaintiff (R. 383, 387);

(e) Defendants have threatened to destroy plaintiff's market for its products, by inducing or attempting to induce present or potential agents, brokers and customers of the plaintiff to boycott and refuse to deal with the plaintiff or in plaintiff's products (R. 383, 387);

(f) Defendants have harrassed the plaintiff directly and indirectly, by threat of vexatious litigation and by pursuing a policy to prevent plaintiff from marketing its production of milk, cheese and other dairy products (R. 383, 387);

(g) Defendants have pursued a policy to effect a reduction in plaintiff's production in order to enhance or achieve a monopolistic position in favor of T.C.C.A. and to the damage and injury of the plaintiff, and have caused, *inter alia*:

(i) a reduction in the production of cheese by plaintiff from about 20,000 pounds per day to about 14,000 pounds per day;

(ii) a reduction in plaintiff's daily Grade A milk market quota of 71,000 pounds per day;

(iii) an accumulation, as of about May 1, 1964, of over three and one half million pounds of cheese in plaintiff's warehouses, which plaintiff was unable to market in the ordinary course of business by reason of the alleged acts of defendants (R. 383, 388).

These contentions and allegations are all denied by defendants in paragraph III of their answer and counterclaim (R. 418).

(3) Plaintiff also contends and alleges that since January, 1963 the defendants have knowingly restrained and plotted to restrain interstate trade or commerce in the production and marketing of milk, cheese and other dairy products by contracting, combining or conspiring with each other and with other persons including, but not necessarily limited to Alpenrose Dairy, Inc., an Oregon corporation, acting by and through Carl H. Cadonau of Portland, Oregon, and the defendant cooperative corporation within itself by and through its officers, agents and employees in violation of Section 1 of the Sherman Act (R. 381-382); that they also combined with each other and with other persons, including, but not necessarily limited to, Alpenrose Dairy, Inc., acting by and through Carl H. Cadonau, to monopolize a certain part of said trade or commerce, in violation of Section 2 of the Sherman Act (R. 382).

Plaintiff further contends that defendants prevented and limited plaintiff from receiving raw products from its patrons and suppliers for the production of milk, cheese and dairy products, and that defendants prevented and impaired to a substantial degree the plain-

tiff from marketing its said milk, cheese and other dairy products in interstate trade or commerce.

All this is denied in part by defendants' answer and counterclaim (R. 418); it is further denied as to Alpenrose Dairy, Inc., and Carl H. Cadonau individually, by Carl H. Cadonau, in his affidavit of September 11, 1964 (R. 112), is denied on behalf of defendant Dixon and T.C.C.A. by affidavit of defendant Dixon of September 11, 1964 (R. 116), and by defendant Warren A. McMinimee in his affidavit of September 11, 1964 (R. 117).

(4) Plaintiff contends and alleges that prior to January, 1963, plaintiff T.C.&D.A. was a member in good standing of defendant T.C.C.A., enjoyed a substantial and profitable business for its patrons and members, having supplied a major and continually increasing portion of milk and cheese graded and marketed by and through the agency of defendant T.C.C.A., and but for the matters alleged in the complaint by T.C.&D.A., plaintiff T.C.&D.A. contends and alleges it would have continued to enjoy a substantial and profitable business for its patrons and members (R. 383, 386).

This is denied by the defendants in paragraph II(d) of their answer and counterclaim (R. 418), except that defendants admit that until September 23, 1963, plaintiff was a member of defendant T.C.C.A.

(5) Plaintiff contends and alleges that plaintiff was forced to terminate its membership in defendant T.C.-C.A. by reason of certain intolerable acts of defendants, and when plaintiff so left T.C.C.A., T.C.C.A. kept

possession and control of some 4 million pounds of plaintiff's cheese, which plaintiff contends T.C.C.A. had since sold and for which T.C.C.A. and Dixon have refused to account to plaintiff (R. 384, 386). This is denied by defendants' answer and counterclaim, paragraph II(e) (R. 418).

(6) Plaintiff contends and alleges that its investment in its plant and production facilities, worth over one million dollars, was being depreciated by reason of defendants' alleged conduct in violation of the Sherman Act (R. 385, 386). This is denied in defendants' answer and counterclaim (R. 418).

(7) Plaintiff further claims severe damage and injury at the hands of the defendants, in excess of two million dollars. This is denied by defendants in its answer and counterclaim (R. 418), which in turn claims Five Million dollars compensatory and Five Million dollars punitive damages against T.C.&D.A. (R. 423).

(8) Plaintiff contends that Alpenrose Dairy, Inc. of Portland is an "outsider" as far as the co-operative "family" of T.C.C.A. is concerned, and was a party to the combination or conspiracy with which plaintiff charged defendants in violation of Sections 1 and 2 of the Sherman Act. A suggestion of testimony which would be offered at trial, tending to support the allegation of plaintiff relative to Alpenrose Dairy, Inc.'s participation in the alleged combination or conspiracy with the defendants, is found in the affidavits of Hans Leuthold (R. 333-337), Del Mayer (R. 338-339), Joe Donaldson (R. 340-341), and Vern Lucas (R. 346-348).

That Alpenrose Dairy, Inc. of Portland is such an "outsider," is not disputed by defendants or by Alpenrose Dairy, Inc. (R. 110-112, 398); defendants, and Alpenrose Dairy, Inc. deny the alleged combination or conspiracy (R. 110-112, 115, 117).

(9) Plaintiff contends that defendant Warren A. McMinimee acted not merely as lawyer for T.C.C.A. and the other individual defendants, but was an independent actor, in effect, to the extent that he is alleged to have actively participated in the formulation of the policy and conduct of T.C.C.A.[6] directed against plaintiff, beginning at least as early as January, 1963, that defendant Warren A. McMinimee is alleged to have counselled and actively participated with T.C.C.A. in organizing the Tillamook Fluid Milk Shippers Association, a direct competitor of plaintiff, acted as its attorney (R. 305-306, 324) to the damage of plaintiff, while plaintiff was still a member of T.C.C.A., and while being paid legal fees by T.C.C.A. (and thus, indirectly by plaintiff); plaintiff also charges defendant McMinimee with attempts to destroy, by threats of litigation and other means, the source of credit to plaintiff at certain pertinent times; that instead of merely carrying out policies and desires of the Board of T.C.C.A. as its attorney, plaintiff ascribes to defendant Warren A. McMinimee the leadership of a faction of the Board of T.C.C.A. These contentions are found in the pleadings, and the affidavits of Del Mayer (R. 338-339), Joe

[6] T.C.C.A. at that time was the marketing agent for plaintiff and other producers in Tillamook County; T.C. & D.A. left T.C.C.A. in September, 1963.

Donaldson (R. 340-341), Glenn Johnston (R. 343-344), Floyd Woodward (R. 345), Vern Lucas (R. 346-348), George Milne (R. 349-361), Barbara Milne (R. 362-366), Clem Hurliman (R. 367-371), Basil Tone (R. 372-373), and also in testimony offered by plaintiff at a pre-trial hearing (Tr. 94-153). These contentions, if offered as testimony upon trial, would tend to support plaintiff's contention that defendant McMinimee was more than a mere attorney for defendant T.C.C.A.

For example, Vern Lucas, a member of the Board of Directors of T.C.&D.A., the plaintiff, and during plaintiff's membership in T.C.C.A. a representative of T.C.&D.A. to T.C.C.A.'s Board of Directors, alleges in his affidavit that defendant Warren A. McMinimee advised a vote on the T.C.C.A. Board on a crucial issue while two T.C.&D.A. representatives, George Milne and Hans Leuthold were out of the room (R. 347). George Milne in his affidavit (R. 350) states that defendant Warren A. McMinimee personally aided in T.C.C.A.'s effort to boycott T.C.&D.A. in its fledgling marketing activities, approved the sending out by Mr. Dixon, General Manager of T.C.C.A., "of the many threatening letters to the trade, and I am advised that Mr. McMinimee publically acknowledged that it was wrongful to do so, but that they would proceed to send the letters out anyhow." Attached to this affidavit by Mr. Milne is correspondence between defendant Warren A. McMinimee and the First National Bank of Oregon, Portland, in which Mr. McMinimee, *inter alia,* accuses the Bank of conspiring with T.C.&D.A. to the damage of T.C.C.A. by lending to T.C.&D.A. Mr. Milne quotes

from the Bank's response of January 21, 1964, through its attorneys, addressed to Mr. McMinimee:

> "The impression we have acquired from your recent letter is that you are not actually interested in this phase of the matter and that the real basis for your objection and criticism is that the Bank is lending any money at all to T.C.&D.A." (R. 350, 358).

Plaintiff contends, in short, that defendant Warren A. McMinimee is an individual, an independent actor and not a cooperative, not a potential member of T.C.-C.A., and that he has forfeited such immunity as he might have enjoyed as a mere lawyer and counsel to his clients, upon trial. Plaintiff contends that Warren A. McMinimee has played a dominant role, wearing in fact a number of hats in this drama in Tillamook County where the defendants, hand in hand with Alpenrose Dairy, Inc., have, so plaintiff alleges, tried to cause the economic downfall, destruction and demise of plaintiff.

All these contentions are denied, in effect, Mr. McMinimee claiming to have at all times been solely the lawyer for T.C.C.A. (R. 117), while also acting as counsel for other co-operatives, members of T.C.C.A. (Tr. 245) and the Tillamook Fluid Milk Shippers Association (R. 305).

C. Questions Raised on Appeal.

This is an appeal from two summary judgments; thus, the questions before this Court are:

Do the pleadings, depositions, and affidavits, and the testimony in the record of the pre-trial proceedings show any genuine issue as to any material fact to be resolved by trial? —

(1) With respect to all defendants as to plaintiff's first claim, i.e. the alleged conspiracy to restrain trade in violation of Section 1 of the Sherman Act, and the alleged conspiracy to monopolize in violation of Section 2 of the Sherman Act; and

(2) With respect to defendant Warren A. McMinimee as to the second claim, i.e. the alleged attempted monopolization in violation of Section 2 of the Sherman Act.

Basic to the resolution of at least the first question in the case at bar is the scope of the immunity granted an agricultural cooperative from the proscriptions of the antitrust laws, i.e.

(a) Is this immunity available to defendants if they have gone beyond *lawfully* carrying out the *legitimate* objectives of T.C.C.A. and

(b) If defendants have combined or conspired with Alpenrose Dairy, Inc., an "outsider," admittedly not a cooperative or even a potential member thereof, — is the immunity otherwise enjoyed by labor unions and agricultural cooperatives lost to these defendants?

If the answer to either (a) or (b) is yes,—and appellant submits it is "yes" to both,—the question is then posed: Can the premise to both questions be re-

solved by the summary judgment on the record here, or must the premise, i.e.

> (a) Did defendants keep *within* the limits of *lawfully* carrying out the *legitimate* objectives of the cooperative, T.C.C.A., and
>
> (b) Did defendants in fact combine or conspire with Alpenrose Dairy, Inc.,[7] and possibly others, as alleged by plaintiff and denied by defendants and Alpenrose Dairy, Inc.

be resolved on trial?

The question raised by plaintiff's appeal from the summary judgment in favor of defendant Warren A. McMinimee is whether a lawyer for an agricultural cooperative can be personally liable for actively participating in an alleged violation of the antitrust laws.

The question could further be raised whether the allegation of defendant Warren A. McMinimee's participation in the alleged combination or conspiracy would also vitiate the cooperatives' exemption by reason of defendant McMinimee's status as an "outside party"; this question, we think, will not need to be resolved since the alleged participation of Alpenrose Dairy, Inc., admittedly an "outside" party,[7] is sufficient to overcome the statutory "immunity" of T.C.C.A.

The question before this Court is not whether or not

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[7] Alpenrose Dairy, Inc., is admitted by defendants to be an Oregon corporation, commercially and privately owned, distinct from and not part of T.C.C.A., clearly not a co-operative or potential member of T.C.C.A. (R. 398). See Cadonau's deposition, Tr. 268-306, and his affidavit (R. 110-112).

defendants have in fact violated the antitrust laws in any particular. The question is whether the record shows disputed material contentions or whether it shows that summary judgment was justified by a record clearly showing what the truth as to all material matters of fact is, that no genuine issue remains for trial and that the plaintiff-appellant is not cut off from its right to a day in Court.

Appellant asks this Court to give it an opportunity to prove its claims of violation of the antitrust laws by combination or conspiracy as well at attempted monopolization against all defendants. Appellant asks this Court, of course, to look at the record in the light most favorable to plaintiff-appellant, the party opposing summary judgment, and to conclude that summary judgment should not have been granted in this case, and that plaintiff may claim its day in Court.

SPECIFICATION OF ERRORS

1. The trial court erred in allowing the motion of defendants for summary judgment as to the first claim of plaintiff's second amended complaint (R. 437).

2. The trial court erred in allowing defendant Warren A. McMinimee's motion for summary judgment as to the second amended complaint (R. 441).

SUMMARY OF ARGUMENT

It is axiomatic that summary judgment must be used sparingly, and appellant urges this Court to reverse the trial Court's orders of summary judgment.[8]

Summary judgment, as a means of terminating litigation, is particularly inappropriate in a complex antitrust case where there is not one, but a plethora of disputed matters of fact for resolution by trial.

Here, these disputed "facts", or, the parties' contentions about matters of fact, are set forth in this brief in some detail; perhaps unnecessarily prolix, because the trial Court, on the same record, denied summary judgment as to the attempted monopolization charge, except as to defendant McMinimee. As is noted in this brief elsewhere, the factual allegations are practically identical in support of the charge of attempted monopolization under Section 2 of the Sherman Act, which the trial Court permitted to go to trial, and the conspiracy charges under Sections 1 and 2 of the Sherman Act which were struck by summary judgment.

The trial Court distinguished between the *Borden* v. *U. S.*[9] rule, as pointed out in the *Sunkist*[10] case, and

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[8] Except where specifically distinguished, the Summary of Argument and Argument are intended to relate to the appeal of both:

(1) Summary judgment for all defendants as to the first claim of plaintiff's second amended complaint; and

(2) Summary judgment for defendant Warren A. McMinimee as to the second claim of plaintiff's second amended complaint.

[9] 308 US 188 (1939).

[10] 370 US 19 (1962).

the *Maryland and Virginia Milk Producers*[11] case.

Sunkist holds a co-op or group of co-ops is immune from the conspiracy provisions of the antitrust laws for *interorganizational* activities, while affirming the validity of

Borden, which holds agricultural co-ops liable for conspiracy with outsiders, and

Maryland and Virginia Milk Producers Association, which holds agricultural co-ops liable for monopolization or attempted monopolization, even *without* outsiders.

The trial judge, in granting summary judgment, apparently overlooked the "outsider," in this case, Alpenrose Dairy, Inc.[12] The trial judge apparently accepted the self-serving declaration of Alpenrose Dairy's general manager that it did not combine or conspire with the defendants, ignored plaintiff's affidavits to the contrary, and thus deprived plaintiff of a full and fair chance to a trial of all issues.

The trial Court, in granting summary judgment to defendant McMinimee, overlooked plaintiff's accusations under oath, and apparently accepted the self-

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[11] 362 US 458 (1960).

[12] Appellant does not overlook that defendant McMinimee could qualify as an "outsider" or "independent actor", but merely suggests, arguendo, that a question of fact, to be resolved at trial, exists as to whether or not defendant McMinimee is an "independent actor" and would thus qualify to take T.C.C.A. out of the *Sunkist* rationale. No such question exists with respect to Alpenrose Dairy, Inc. on this record.

serving declarations by defendants and Mr. McMinimee to the contrary.

This is error. Appellant submits, not only is a lawyer as such not immune from being held to account under the antitrust laws, but, as a lawman, an officer of the courts, an attorney should be held to at least as high, if not higher standard of lawfulness as a layman. Certainly nowhere have we found a lawyer, as such, exempt from the proscriptions of the antitrust laws.

Appellant respectfully urges reversal of the summary judgments because

1. They are clearly improper because of many disputed issues of fact in the record which must be resolved by trial;

2. They are peculiarly inappropriate in an antitrust case, such as this one, and the ends of justice would be better served by trial than by summary disposition;

3. All leading cases, under Rule 56 (c) of the Federal Rules of Civil Procedure, and in the antitrust field, support reversal, as will be shown below, and all doubts as to facts or allegations about matters of fact in the record to date must be resolved in this instance, and before this tribunal, in appellant's favor; and

4. Neither T.C.C.A., nor any other agricultural cooperative, is free, by any statute or Court's decision known to appellant, to act as a predator in the market place, to plan and scheme to destroy competition for its gain and to its competitor's

damage; such conduct is unlawful; and such conduct is by this cause laid at defendants' door. The charges must be tried.

ARGUMENT

1. Numerous genuine issues of fact are raised on the record, by the pleadings and affidavits, which cannot be resolved by self-serving declarations of defendants and their alleged co-conspirators.

The complaint alleges an agreement, combination or conspiracy between T.C.C.A., certain of its officers or directors, Mr. McMinimee, and Alpenrose Dairy, Inc., and others outside T.C.C.A. (R. 380). Self-serving statements of some of the alleged co-conspirators (R. 110-118) that they were not involved in any conspiracy, without opportunity for cross examination, and before full pretrial discovery, are insufficient to support a finding that there was no conspiracy, no combination and no agreement. Mere statements by affiants that they acted only in their official capacities as agents of the association are likewise unimpressive. Mr. McMinimee's affidavit (R. 117-118) claims that he acted only in his capacity as attorney for T.C.C.A. Yet, the plaintiff names him as an individual, the logical inference being that plaintiff desires to prove that on certain relevant and material occasions, Mr. McMinimee acted as an individual and outside the scope of his employment as attorney. This applies as well to other named individual defendants.

Defendants and Alpenrose Dairy, Inc., one of the alleged co-conspirators, deny plaintiff's charges. There

has been no trial; however, the issues are factual and disputed and unresolved.

A trial,—not summary disposition,—is the proper way to resolve these issues. *Poller* v. *Columbia Broadcasting System,* (1962) 368 U.S. 464, 7 L. Ed. 2d 458; *White Motor Co.* v. *U. S.*, (1963) 372 U.S. 253, 9 L. Ed. 2d 738.

That such issues exist is implicit in the Court's denial of summary judgment as to plaintiff's claim of attempted monopolization (the second claim of plaintiff's second amended complaint) against the same defendants, except Warren A. McMinimee (R. 437-438, 441-442).

Summary judgment may not be entered where there is a material issue as to any material fact. *Dredge Corporation* v. *Penny* (9 Cir. 1964) 338 F.2d 456.

A quotation from *Jackson Tool & Die, Inc.* v. *Smith* (5 Cir. 1964) 339 F.2d 88, is particularly appropriate in the case at bar:

> "Summary judgment can be granted only if there is no genuine dispute as to any material fact. This requirement is to be strictly construed so as to insure that factual issues will not be determined without the benefit of the truth-seeking procedures of a trial. (F.R.Civ.P. 56(c), 28 U.S.C.A.). This case bristles with triable issues of fact, precluding the sustaining of either a motion to dismiss or a motion for summary judgment for any party to this appeal." 339 F.2d, at 91.

2. Special exigencies of antitrust litigation are recognized by the Supreme Court as limiting advisability of summary judgment in antitrust cases.

Faith in summary proceedings is declining rapidly. In *Poller* v. *Columbia Broadcasting System,* supra, the Supreme Court not only recognized the general disenchantment with summary proceedings but held forth on the particular weaknesses of that procedure in complex antitrust litigation. In reversing a summary judgment in a treble damage action based on alleged violations of Sections 1 and 2 of the Sherman Act, the Supreme Court held:

> "Summary judgment should be entered only when the pleadings, depositions, affidavits, and admissions filed in the case 'show that [except as to the amount of damages] there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.' Rule 56 (c), Fed Rules Civ Pro. This rule authorizes summary judgment 'only where the moving party is entitled to judgment as a matter of law, where it is quite clear what the truth it, . . . [and where] no genuine issue remains for trial . . . [for] the purpose of the rule is not to cut litigants off from their right of trial by jury if they really have issues to try.' *Sartor* v. *Arkansas Natural Gas Corp.,* 321 U.S. 620, 627, 88 L. Ed. 967, 972, 65 S. Ct. 724 (1944).
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> * * * * *
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> "We look at the record on summary judgment in the light most favorable to Poller, the party opposing the motion, and conclude here that it should not have been granted. We believe that summary

procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot. It is only when the witnesses are present and subject to cross examination that their credibility and the weight to be given their testimony can be appraised. Trial by affidavit is no substitute for trial by jury, which so long has been the hallmark of 'even handed justice.'" 368 U.S. at 468, 473, 7 L. Ed. 2d at 461, 464.

This teaching by the Supreme Court superbly fits the present case. Defendants' motion for summary judgment should not have been granted; it should be reversed.

3. T.C.C.A. has no immunity as an agricultural cooperative from the conspiracy provisions of the anti-trust laws when it combines or conspires with outsiders.

Defendants moved for summary judgment in reliance on *Sunkist Growers, Inc. et al* v. *Winkler* & *Smith Citrus Products Co. et al.*, (1962), 370 U.S. 19, 8 L. Ed. 2d 305 (R. 396), and Sec. 6 of the Clayton Act[13] and

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[13] *Clayton Act, Section* 6:
"That the labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or being conducted for profit, or to forbid or restrain individual members of such organizations *from lawfully carrying out the legitimate objects thereof;* nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws." [15 U.S. Code, § 17] (emphasis supplied).

Section 1 of the Capper-Volstead Act,[14] which statutory provisions are claimed as basis for immunity of agricultural cooperatives from the conspiracy provisions of the antitrust laws.[15]

The trial court erred in granting summary judgment for defendants as to plaintiff's conspiracy charges, ap-

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[14] *Capper-Volstead Act, Section* 1:—Authorization of Associations; Powers.

> "Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in association, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate commerce and foreign commerce, such products of persons so engaged. Such associations may have marketing agencies in common; and such associations and their members may make the necessary contracts and agreements to effect such purposes: *Provided, however,* that such associations are operated for the mutual benefit of the members thereof, as such producers, and conform to one or both of the following requirements: * * *" (7 U.S. Code, § 291).

[15] Plaintiff does not know whether defendant T.C.C.A. qualifies as a Capper-Volstead cooperative, at this time, for two reasons: (1) Plaintiff is not certain that the purchase and sale of nearly 1,000,000 pounds of Minnesota cheese (R. 27-30, Tr. 37-48) is a legitimate objective of T.C.C.A. under Capper-Volstead language which exempts only those cooperative associations which are engaged in "processing, preparing for market, handling, and marketing . . . products of persons so engaged" as farmers, planters, ranchmen, dairymen, nut or fruit growers. (2) Plaintiff is uninformed as to defendant T.C.C.A.'s tax exempt status as a nonprofit agricultural cooperative. Plaintiff calls attention to the financial statements released by T.C.C.A. for its accounting period ended March 31, 1964 (R. 220-262). The statements were prepared (without audit) by Peat, Marwick, Mitchell & Co., (R. 222) defendant T.C.C.A.'s C.P.A.s, who felt obligated to note [note 4, to the financial statements (R. 227)] that by reason of certain ". . . acts and resolutions adopted . . . and subsequent rescinding thereof . . ." T.C.C.A.'s status as an exempt cooperative is in question.

These matters may have to be determined on trial. For ultimately, whether defendant T.C.C.A. qualifies as a Capper-Volstead Cooperative will determine whether they are entitled to any exemption, whatsoever, from the antitrust laws.

pellant submits, upon a reading of the case principally relied upon by defendants, the *Sunkist* case.

Sunkist is the most recent judicial pronouncement concerning the scope of immunity granted agricultural cooperatives; in *Sunkist* the Supreme Court found the interorganizational dealings among three cooperatives immune from the conspiracy provisions of the antitrust laws, but—significantly—concluded:

> "Suffice it to say that our decision in no way detracts from earlier cases holding agricultural co-operatives liable for conspiracies with outside groups, United States v. Borden Company, 308 US 188 (1939), and for monopolization, Maryland and Virginia Milk Producers Association v. United States, 362 US 458 (1960)." 370 U.S. at 30.

Appellant submits that defendants here are charged with conspiracy with an "outside group": Alpenrose Dairy, Inc. (R. 380-382). "There is no question that Alpenrose Dairy, Inc. is distinct from and not part of the TCCA organization" admit defendants (Reply Memorandum, R. 398).

Thus, the vitality of *United States* v. *Borden Company* (1939), 308 U.S. 188, 84 L. Ed. 181, affirmed by the *Sunkist* decision, limiting "immunity" to inter-organizational dealings within a co-op family, clearly sustains appellant's position that summary judgment should not have been granted by the trial court, and should now be reversed.

In the *Borden* case, the Supreme Court finds the Sherman Act not modified by the Capper-Volstead Act:

"We cannot find in the Capper-Volstead Act, any more than in the Agricultural Act, an intention to declare immunity for the combinations and conspiracies charged in the present indictment. Section 6 of the Clayton Act, enacted in 1914, had authorized the formation and operation of agricultural organizations provided they did not have capital stock or were conducted for profit, and it was there provided that the anti-trust laws should not be construed to forbid members of such organizations 'from lawfully carrying out the legitimate objects thereof.' They were not to be held illegal combinations. The Capper-Volstead Act, enacted in 1922, was made applicable as well to cooperatives having capital stock. The persons to whom the Capper-Volstead Act applies are defined in Section one as producers of agricultural products, 'as farmers, planters, ranchmen, dairymen, nut or fruit growers.' They are authorized to act together 'in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce' their products. They may have 'marketing agencies in common', and they may make 'the necessary contracts and agreements to effect such purposes.'

"The right of these agricultural producers thus to unite in preparing for market and in marketing their products, and to make the contracts which are necessary for that collaboration, cannot be deemed to authorize any combination or conspiracy with other persons in restraint of trade that these producers may see fit to devise." 308 U.S. at 204-205, 84 L. Ed. 193-194.

4. T.C.C.A., as a cooperative, is liable for violation of the conspiracy provisions of the antitrust laws if its predatory practices and anti-competitive conduct go beyond the LAWFUL pursuit of LEGITIMATE objectives.

Section 6 of the Clayton Act exempts agricultural cooperatives from application of the antitrust laws only when they are "lawfully carrying out the legitimate objects" of the association.[16] The complaint clearly charges the defendants with predatory commercial conduct inconsistent with the obvious intention of Congress in affording *legitimate* cooperative activities the protection of Section 6 of the Clayton Act and of the Capper-Volstead Act.

In *April* v. *National Cranberry Association* (US DC Mass. 1958) 168 F. Supp. 19, 1958 C.C.H. Trade Cases, para. 69,218, the court reviews the legislative history of the Capper-Volstead Act and concludes:

> "I can think of no purpose to be served by permitting cooperatives to use unfair methods to put competitors out of business. To permit this would award agricultural cooperatives a very substantial 'privilege or special favor', contrary to the bill's announced purpose and the disclaimers of its sponsors. In the absence of specific language in the act to the contrary, I hold that when Capper-Volstead provided that a cooperative and its members were not to be prohibited from 'lawfully carrying out the legitimate objects thereof . . .' (to use the language of Section 6 of the Clayton Act), at least it did not make lawful purely predatory practices seeking to monopolize, forbidden to an individual corporation,

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[16] See footnotes 13 and 15 supra.

> nor did it deprive the victims of such practices effected with monopolizing intent of their private right of action under Section 4 of the Clayton Act." 58 C.C.H. Trade Cases at p. 74,793.

Section 6 of the Clayton Act, the fountainhead of all immunity for cooperative associations, merely exempts cooperatives when they are LAWFULLY pursuing their LEGITIMATE objectives. [17] The Capper-Volstead Act lists the LEGITIMATE objectives of agricultural cooperatives as "processing, preparing for market, handling, and marketign". It describes the LAWFUL means for carrying out their objectives as "marketing agencies in common" and making "the necessary contracts and agreements to effect . . . [the above] purposes." This language was not intended to immunize predatory practices and competition stifling measures as have been alleged in the amended complaint. This is obvious from the discussion by Mr. Justice Black in *Maryland and Virginia Milk Producers Assn.* v. *United States,* (1960), 362 U.S. 458, 4 L. Ed. 2d 880.

Here, the anti-competitive activities charged in the complaint are indeed outside the *legitimate* objectives of a cooperative and, if proved, would constitute a clear violation of Sections 1 and 2 of the Sherman Act.

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[17] In the first reported case dealing with cooperative exemption after passage of the Clayton Act, *United States* v. *King,* 250 Fed. 908 (1916), the court denied immunity to a cooperative with the following comments:

> ". . . I do not think that the coercion of outsiders by a secondary boycott, . . . can be held to be a lawful carrying out of the legitimate objects of such an association . . . they are not privileged to adopt methods of carrying on their business which are not permitted to other lawful associations." 250 Fed. at 910.

That the exemptions granted to labor unions and agricultural organizations by Section 6 of the Clayton Act are clearly limited to the lawful means of achieving legitimate purposes of these organizations and to interorganizational dealings, has been very recently buttressed by the United States Supreme Court decisions in *United Mine Workers of America* v. *James M. Pennington,* decided June 7, 1965, — U.S. —, 14 L. Ed. 2d 626, 1965 C.C.H. Trade Cases, Para. 71,462, and *Meat Cutters Union* v. *Jewel Tea Co., Inc.,* decided the same day, — U. S. —, 14 L. Ed. 2d 640, 1965 C.C.H. Trade Cases, Para. 71,463.

In the recent case of *Bergjans Farm Dairy Co.* v. *Sanitary Milk Producers,* decided by the United States District Court in Missouri, on March 26, 1965, 1965 C.C.H. Trade Cases, Para. 71,466, the Court also limited the exemptions from the antitrust laws granted to agricultural cooperatives by Section 6 of the Clayton Act and the Capper-Volstead Act as not applying to certain activities beyond the immediate cooperative family.

Summary judgment, on the record here, is not proper, and should be reversed.

5. Defendant McMinimee is personally liable if proven an "independent actor" and co-conspirator; he is not immune from liability under the antitrust laws merely by reason of his role as attorney of T.C.C.A.

In *Cott Beverage Corp.* v. *Canada Dry Ginger Ale, Inc.* (S.D. N.Y. 1956) 146 F. Supp. 300 [appeal dismissed on other grounds, 243 F.2d 795], 1956 C.C.H. Trade Cases, Para. 65,531, the court dealt with the prob-

6. That genuine issues of fact, to be resolved by trial, are present here with respect to each of the touchstones of liability under the conspiracy provisions of the antitrust laws, is borne out by the record. Moreover, on appeal from summary judgment, appellant's version of matters of fact is presumed correct in this court.

The fact in this record, that the trial court denied summary judgment as to the attempted monopolization charge (second claim of plaintiff's second amended complaint) while allowing summary judgment for defendants as to the conspiracy charges (first claim), prompts an examination of the distinction between the two claims.

The record indicates that the factual allegations and averments in affidavits submitted by plaintiff are practically identical in both claims (R. 380 ff); defendants moved for summary judgment against both claims (R. 391); the court drew a distinction between the two claims, as shown in the court's order (R. 409, 437) dismissing one, by way of summary judgment, and permitting the other to go to trial.

The record here indicates that the trial court,—erroneously, we submit,—predicated its allowance of summary judgment on an assumed immunity of defendants from the conspiracy provisions of Sections 1 and 2 of the Sherman Act, while acknowledging the lack of immunity of an agricultural cooperative from the attempted monopolization charge under *Maryland and Virginia Milk Producers Asso.* v. *U. S., supra.* The one distinction between the elements of the two offenses charged

by plaintiff, one the conspiracy, the other the attempted monopolization, is the requirement for an "outside" party in the conspiracy charge (R. 85-90; 378). Appellant submits that an "outside" party is pleaded and alleged to have been a party to the conspiracy (R. 381-382): Alpenrose Dairy, Inc.; this allegation is supported by affidavits (R. 330-337, 338-339, 347) and certain defendants' answers to plaintiffs' interrogatories in the record (R. 298-299, 319, 323, 327) as well.

The fact that Alpenrose Dairy, Inc. is not an actual or potential member of the cooperative family of T.C. C.A., qualifying for the inter-organizational immunity under the *Sunkist* rationale, is obvious, and admitted by defendants (R. 398).

Moreover, plaintiff contends that Defendant Warren A. McMinimee may also be an outside party, if found on trial to have acted beyond the scope of mere legal adviser as attorney for T.C.C.A.; in view of the admitted character of Alpenrose Dairy, Inc. as an outside party, this issue as to Mr. McMinimee need not here be resolved; the presence of either as a participant in the combination or conspiracy suffices to hold defendants liable for the predatory anti-competitive practices charged by plaintiff.

Appellant concedes, *arguendo,* that its version of the facts may not prevail upon trial, but, in this court, and at this time,—on appeal from a summary judgment,—appellant's version of the facts must be accepted by this court for the purpose at hand. *Mahler* v. *U. S.* (3 Cir. 1962) 306 F.2d 713, cert. den. 371 U.S. 923, 9 L. Ed. 2d

231; *Jacobson* v. *Maryland Casualty Co.* (8 Cir. 1964) 336 F.2d 72; *Cross* v. *United States* (2 Cir. 1964) 336 F.2d 431;

Tracerlab, Inc. v. *Industrial Nucleonics Corporation* (1st Cir. 1963) 313 F.2d 97:

> "This appeal, coming to us after the trial judge's grant of a motion for summary judgment, gives rise to the familiar principle that: '* * * a reviewing court must view the evidence in the light most favorable to the party against whom the motion has been granted, according that party the full benefits of all favorable inferences that may be drawn from the evidence in determining whether there exists a genuine issue of material fact.' Atlas v. Eastern Air Lines, Inc., et al., 311 F.2d 156 (1st Cir., 1962), and cases cited therein." at p. 99.

In this Court the same rule has been adopted:

> "While the pleadings and affidavits raise certain disputed questions of fact, they must all be resolved in favor of appellants for the purpose of considering the motion for summary judgment and the appeal therefrom. This is true because a motion for summary judgment is improper where there is left unresolved a genuine issue as to any material fact. Rule 56(c), Federal Rules of Civil Procedure, 28 U.S.C.A." *Carr* v. *City of Anchorage* (9 Cir. 1957) 243 F.2d 482,[18] at 483.

On the record in this case, and in the light of the law applicable here, summary judgment on the first claim

[18] Cited by this Court since, with approval, in footnote to its opinion in *Sequoia Union High School Dist.* v. *U.S.* (9 Cir. 1957), 245 F.2d 227, 229.

and summary judgment in favor of defendant Warren A. McMinimee on the second claim of plaintiff's second amended complaint, are error, must be reversed, and the cause remanded.

CONCLUSION

The questions before this Court are really quite simple:

Is plaintiff to have the opportunity to submit to trial by jury its charges, as alleged by complaint and on affidavits, and to adduce evidence to support its case?

Or, is plaintiff to be foreclosed by summary judgment, without full pretrial discovery, and before trial, from its day in Court?

Granting that a conspiracy charge under Sections 1 and 2 of the Sherman Act cannot reach mere interorganizational combinations within an agricultural cooperative family, such as T.C.C.A., without the presence of an outside party, appellant submits that at least one undisputed outsider, Alpenrose Dairy, Inc., was a part, and an important part, of the combination or conspiracy which defendants aimed at plaintiff in defendants' effort to snuff out plaintiff's economic life.

The record shows plaintiff has met the test of *Sunkist* and *Borden* v. *U. S.* by all standards applied to review of summary judgments.

Justice can only prevail, and tranquility return to the green pastures of Tillamook County, when all genuine

issues, all disputes between the parties are resolved at the bar of justice, in orderly fashion, and upon full trial.

Appellant asks its day in Court.

We respectfully submit that the summary judgments on appeal should be reversed, and the cause remanded for trial.

Dated: July 16, 1965.

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Of Counsel

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion the foregoing brief is in full compliance with those rules.

ERNEST BONYHADI

No. 20101

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

THE BOBRICK CORPORATION,

Appellant,

vs.

AMERICAN DISPENSER CO., INC.,

Appellee.

APPELLEE'S BRIEF.

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No. 20101

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

The Bobrick Corporation,

Appellant,

vs.

American Dispenser Co., Inc.,

Appellee.

APPELLEE'S BRIEF.

JURISDICTION.

This is a patent infringement suit brought by The Bobrick Corporation, Appellant herein, against American Dispenser Co., Inc., Appellee herein, and others. The District Court had jurisdiction of the subject matter under 28 U.S.C. 1338(a). The Appellee brought a motion to dismiss the suit against it for lack of jurisdiction over the person and for lack of proper venue under 28 U.S.C. 1400(b). The motion was granted and Appellant has appealed to this court. It is contended by Appellee that the District Court does not have jurisdiction of this case for the reasons set forth in its motion, but it is admitted that the Court of Appeals has jurisdiction to hear this appeal under 28 U.S.C. 1291 and 1292(4).

STATEMENT OF PLEADINGS.

On *October 27, 1964,* The Bobrick Corporation, Plaintiff and Appellant herein, filed suit for infringement of a patent on soap dispensers against D. J. Alexander; D. J. Alexander Corporation; American Dispenser Co., Inc., the Appellee herein; Burton L. Feinson; Shore-Robertson & Associates, a co-partnership consisting of Philip Shore and David Shore; and Southland Janitor Supply Company, a partnership consisting of David Kashinsky and Morris Smith [TR 1-4]. Suits against D. J. Alexander and D. J. Alexander Corporation have been dismissed on their unopposed motion for lack of proper venue.

The Marshal's returns state that on *November 12, 1964,* Shore-Robertson & Associates was served by leaving a copy with Philip Shore, a co-owner, Philip Shore was served by leaving a copy with Philip Shore, Individually, and American Dispenser Co., Inc. was served by leaving a copy with Philip Shore "the co-owner of Shore-Robertson & Associates, the western distributor of American Dispenser Co., Inc. products". [Supp. TR.]

On *December 17, 1964,* Burton L. Feinson, General Manager of American Dispenser Co., Inc. was served in New York City with a copy of the summons and complaint [Supp. TR.].

CONCISE STATEMENT OF PERTINENT FACTS.

The Complaint joined six parties as co-defendants. There is no indication in the Complaint what the relationships of the different co-defendants are. For example, there is no indication in the Complaint that Shore-Robertson & Associates, hereinafter referred to as Shore-Robertson, was being sued in its individual capacity as infringer and that it was also considered by Appellant to be an agent of the Appellee or even a distributor of the Appellee's products.

It is not clear from the records how Shore-Robertson was served. It is not shown whether Shore-Robertson was served with three copies of the summons and complaint, but in any case, from the record [Supp. TR.], it appears that on the face of the summons, the party being served was not indicated after the salutation, "To the above named Defendant:". In any case, Philip Shore was not served with a summons and/or Complaint indicating that it was intended for American Dispenser Co., Inc., hereinafter referred to as American Dispenser. Shore-Robertson did not inform American Dispenser that it had been served as a "distributor of American Dispenser Co., Inc. products".

On December 17, 1964, Burton L. Feinson was served in New York with a Complaint and summons [Supp. TR.]. The summons did not indicate after the salutation, "To the above named Defendant:" whether Feinson was being served in his individual capacity or whether

American Dispenser was being served through Feinson as its General Manager. American Dispenser, *without* knowledge that attempts had been made to serve it in California by service on Shore-Robertson as "western distributor of American Dispenser Co., Inc. products" and *without* knowledge as to whether Feinson had been served in his individual capacity or as an officer of American Dispenser, on January 6, 1965 filed a motion pursuant to Rule 12(b) of the Federal Rules of Civil Procedure for an order "that the return of summons upon the defendant Burton L. Feinson *and/or* American Dispenser Co., Inc. in New York City be quashed for lack of jurisdiction over the person and that this action be dismissed as to said defendants, Burton L. Feinson and American Dispenser Co., Inc. for improper venue" [TR 11 & 12]. In support of that motion, the affidavit of Feinson was filed, indicating that he did not know whether he "was being served personally as a defendant or American Dispenser Co., Inc. was being served through me (him) as an officer" [TR. 28, lines 16-25]. In its Memorandum in support of its motion, American Dispenser stated:

> "No attempt was made to serve American Dispenser Co., Inc., or Burton L. Feinson until December 17, 1964, when the Marshal of the Southern District of New York made an attempted service by handing a single copy of the complaint and the summons to Burton L. Feinson at his office in New York City * * * It is assumed for the purpose of these motions that the attempted service was intended for both of said defendants, although it was defectively made." [TR 12, lines 23-32].

It is apparent from the foregoing facts that American Dispenser had no knowledge of any attempted service on it in California through Philip Shore.

Up to the time American Dispenser brought its motion to quash service and dismiss for lack of proper venue, *no* request was made by the Appellant, The Bobrick Corporation, hereinafter referred to as Bobrick, to enter default against American Dispenser based on service in California on Philip Shore. However, on January 11, 1965, Bobrick filed a Request to Enter Default Against American Dispenser Co., Inc. for Failure to plead, directed to the clerk of the United States District Court for the Southern District of California under Rule 55(b) (1) instead of directing it to the Court under Rule 55(b) (2) [TR 103].

In Bobrick's opposition to the motion of American Dispenser to quash service for lack of jurisdiction over the person and to dismiss for improper venue, one of the grounds set forth for the opposition was that the motion was too late [TR 34, line 30]. Bobrick in its Memorandum of Points and Authorities in opposition to the motion of American Dispenser, submitted arguments that American Dispenser was in default and, therefore, had waived the right to raise the issue of lack of venue [TR 37, lines 19-23].

By order signed January 25, 1965 by Judge Westover, the return of service upon Burton L. Feinson was quashed and action as to Feinson was dismissed [TR 54]. No appeal has been taken on this order.

Also in this order, the Appellant was granted the right of "discovery on the issue of whether American Dispenser Co., Inc. has committed acts of infringement

and has a regular and established place of business within the Southern District of California" [TR 55]. *Bobrick raised no objections to the order and indicated its approval thereof by the approval signature of its attorney on the proposed order.*

Pursuant to Judge Westover's order of January 25, 1965, the deposition of Philip Shore was taken by Bobrick on March 2, 1965. *No objection was made to any questions asked by Bobrick's attorney on the ground that Bobrick was exceeding the scope of Judge Westover's order.* If Bobrick's attorney had asked special questions directed to the issue as to whether Philip Shore was an agent of American Dispenser for the service of summons in the State of California, assuming that such questions had no bearing on the question of venue, he would have been free to ask them. Moreover, it would have been difficult or impossible to distinguish questions dealing with the agency of Shore-Robertson to receive service on behalf of American Dispenser and questions directed to the issue of whether American Dispenser had a regular and established place of business on the issue of venue. Bobrick, therefore, notwithstanding the wording of Judge Westover's order of January 25, 1965, had full opportunity, in its examination of Philip Shore to prove that Philip Shore was an agent of American Dispenser for the purpose of service in the State of California. The Court did *not* prohibit discovery on the issue of jurisdiction over the person, as contended by Bobrick in its brief, page 5.

The affidavits of Burton L. Feinson in support of the motion of American Dispenser to quash service as to American Dispenser and to dismiss the action against it for lack of proper venue, show the following:

(1) American Dispenser does not make, use or sell soap dispensers in the State of California; it sells *in New York* soap dispensers and ships them to Shore-Robertson, as a customer, in California [TR 29, lines 1-5].

(2) American Dispenser has no financial interest in Shore-Robertson [TR 29, lines 5-6].

(3) Shore-Robertson is a sales organization independent of American Dispenser and buys outright from American Dispenser. Shore-Robertson is billed F.O.B. New York, by American Dispenser as soon as the soap dispensers are shipped from New York and the cost of shipping is charged to Shore-Robertson. Payments of the bills are mailed to the New York office of American Dispenser. Shore-Robertson alone is liable to American Dispenser for the payment of bills rendered by American Dispenser to Shore-Robertson [TR 29, lines 17-18; TR 83, lines 27-32; TR 84, lines 1-32].

(4) Shore-Robertson resells in California and other states solely on its own behalf, soap dispensers that it buys from American Dispenser, without control from American Dispenser and does its own warehousing and its own invoicing [TR 29, lines 19-23].

(5) Shore-Robertson not only buys from American Dispenser but also deals and sells products from other suppliers free from any control by American Dispenser.

(6) American Dispenser has no place of business in California, established, regular or otherwise, owns or leases no property in California, pays no rent, makes no reimbursements for rent paid by others, and pays no salaries or commissions in California. Although there is a telephone listing of American Dispenser in the southern district of California, this listing was made by Shore-Robertson at the latter's expense. American Dispenser keeps no stock and has no warehouse in California and has no agent acting on its behalf [TR 30, lines 1-11].

The deposition of Philip Shore taken by Bobrick on March 2, 1965 pursuant to the right of discovery granted to Bobrick shows:

(1) Shore-Robertson bought soap dispensers from American Dispenser and sold them as its own [Dep. pp. 12, 13].

(2) Shore-Robertson stores the merchandise which it buys from American Dispenser in a warehouse owned by Shore-Robertson and stores other merchandise therein sold by Shore-Robertson [Dep. p. 16].

(3) American Dispenser does not consign merchandise to Shore-Robertson [Dep. p. 20].

(4) Other firms besides American Dispenser use the address of Shore-Robertson in its advertising [Dep. p. 27].

(5) The name of American Dispenser was placed on a sign at the address of Shore-Robertson, without the consent of American Dispenser [Dep. pp. 28-30].

(6) No one connected with American Dispenser holds any stock or has any financial interest in Shore-Robertson [Dep. p. 31].

(7) Shore-Robertson maintains a stock of merchandise which it has purchased from American Dispenser and others and Shore-Robertson pays the personal property tax on this merchandise [Dep. p. 34].

(8) Shore-Robertson paid for a booth at the NSSA (National Association Sanitary) West Coast Trade Show displaying American Dispenser goods [Dep. p. 39].

(9) Shore-Robertson was not reimbursed for the payment of the booth at the end of the NSSA Trade Show [Dep. p. 41].

(10) Shore-Robertson had its own salesman taking orders at the booth of the NSSA Trade Show [Dep. p. 42].

(11) Shore-Robertson authorized listing of American Dispenser in the telephone book at its own expense without consulting American Dispenser [Dep. p. 54].

(12) Shore-Robertson listed in the telephone directory the names of others whose products it sold besides that of American Dispenser and has received no payment or rebate therefor. American Dispenser has not paid one cent in the last 25 years for any listing in the telephone directory in the Southern Judicial District of California [Dep. pp. 56-58].

(13) Shore-Robertson has checks to prove that it purchased and paid for all merchandise received from American Dispenser [Dep. p. 62].

(14) Shore-Robertson has no indemnity agreement with American Dispenser for American Dispenser to assume the expense of any infringement suit against Shore-Robertson [Dep. p. 63].

(15) American Dispenser pays no part of the rent for the premises occupied by Shore-Robertson [Dep. p. 63].

(16) Neither Mr. Burton L. Feinson nor any one connected with American Dispenser has ever been at the premises of Shore-Robertson [Dep. p. 65].

(17) Shore-Robertson does not use American Dispenser invoices in the sale of American Dispenser products [Dep. p. 67].

On December 17, 1964, American Dispenser filed a suit in the United States District Court for the District of Delaware against The Bobrick Corporation, the Appellant in the case at bar, for a Declaratory Judgment holding the patent now involved in the present suit, invalid and not infringed. Bobrick in the Delaware suit, after filing of its appeal herein, made a motion to Dismiss the Complaint or to Stay Action on the ground that all matters and issues involved in the Delaware suit were involved in and fully determinable by proceedings already pending in the United States for the Southern District of California and by order dated June 29, 1965, Judge Steel denied this motion. Bobrick, in the Delaware suit, has filed its Answer with Counterclaim for infringement of the patent here involved.

Bobrick has not shown that American Dispenser makes, uses or sells soap dispensers in the State of California, and therefore, has not shown that American Dispenser has committed any acts of infringement in the State of California.

SUMMARY OF ARGUMENT.

The issue of default was before Judge Westover in connection with (1) the motion of American Dispenser to dismiss the action as to American Dispenser for improper venue, (2) Bobrick's contention in opposition to the motion that this motion was too late [TR 34, line 30], and (3) Bobrick's Request for Entry of Default [TR 103], and after considering the affidavits in the case and the deposition of Philip Shore taken on discovery granted Bobrick, the District Court held in effect that there was *no* default because "Philip Shore is not an agent thereof for the service of summons in the state of California" [TR 101, lines 30, 31]. That should dispose of the question of default.

The facts elicited by affidavits and deposition determining the question of whether American Dispenser had a regular and established place of business in the Judicial District of Southern California, also established that Philip Shore was *not* an agent of American Dispenser for the service of summons in the State of California.

The affidavits and deposition in the case show that American Dispenser has no regular and established place of business in the Southern Judicial of California.

ARGUMENT.

I.

AMERICAN DISPENSER DID NOT WAIVE ITS RIGHT TO HAVE THE ACTION AGAINST IT DISMISSED ON THE GROUND THAT THE COURT DOES NOT HAVE JURISDICTION OVER ITS PERSON.

The service on Philip Shore as "western distributor of American Dispenser Co., Inc. products" was improper service. There was no showing that Philip Shore was a proper person for service as an agent of American Dispenser, no showing that Philip Shore knew that he was being served as "western distributor of American Dispenser Co., Inc. products", no showing that Philip Shore was authorized to receive service on behalf of American Dispenser, no showing that Philip Shore was so integrated into the organization of American Dispenser as to obligate him to inform American Dispenser of attempted service of process on him on behalf of American Dispenser, and no showing that American Dispenser knew of the attempted service on it in California through service on Philip Shore.

Also, the return on the service of the complaint by U.S. Marshal on Philip Shore did not constitute upon its face a lawful return. Any one distributing a product of a company is not necessarily an agent of the company for the service of process on said company under the law.

Although the motion of American Dispenser of January 7, 1965 did not specifically mention the attempted service on it in California through service on Philip Shore, because of its lack of knowledge thereof,

it did headline the motion broadly as a Motion to Quash Service for Lack of Jurisdiction Over the Person and to Dismiss for Improper Venue and at the end of the motion asked for the "dismissal of the action against American Dispenser Co., Inc." [TR 11 & 26]. Also, in its reply to Bobrick's opposition to the motion of American Dispenser, it was indicated broadly that the District Court did "not have jurisdiction over the person of American Dispenser Co., Inc." and asked broadly for dismissal of the action "for lack of jurisdiction over the person" [TR 52]. These requests for dismissal of the action against American Dispenser were comprehensive enough to include a request for dismissal of the complaint on the ground of improper service, either in New York or California and on the ground that it would be impossible to effect proper service in these jurisdictions in view of the absence of American Dispenser in California. Bobrick based its opposition to the motion of American Dispenser to quash service on the ground that the motion was too late because of service on American Dispenser in California through Philip Shore [TR 34, line 30]. Also, Bobrick, before the motion was heard filed a Request for Entry of Default [TR 103]. Bobrick brought into the motion the issue of default because of service on Philip Shore on behalf of American Dispenser and this issue became an integral part of the motion. At the final hearing of the motion before Judge Westover on March 29, 1964, Bobrick's attorney argued at great length that service upon Philip Shore was binding upon American Dispenser [TR 98]. The issue, therefore, was before the court before entry of the final order of dismissal. Judge Westover in his final order, after considering this issue, in effect ruled

that there was no default, because "Philip Shore is not an agent thereof (American Dispenser) for the service of summons in the State of California". Certainly, Judge Westover would not have made this finding, if the issue had not been before him, and if he had not considered the issue on its merits. Under these conditions, American Dispenser did not waive the lack of jurisdiction over its person arising out of service in California, and Bobrick was not deprived of a full hearing on its objection to the motion.

Bobrick on page 7 of its brief, refers to Rule 12-(g) and (h) of the Federal Rules of Civil Procedure in an attempt to show that American Dispenser waived jurisdiction over its person arising over attempted service in California. The Rule prevents one motion of a definite class from being brought after another motion of the same class has been brought. There are no prescribed Rules in the Federal Rules of Civil Procedure regarding the form in which a motion must be brought. It can be brought formally at the discretion of the District Court, it can be brought informally in open court; it can be explicit or implicit; and correlated issues and supplementary motions can be injected into the basic motion up to the time the basic motion is argued and decided. Until a motion is argued and decided, it is still considered a pending motion in the process of being formulated and can be modified or supplemented at the discretion of the district court until the decision is handed down.

In the instant case, assuming that the motion of American Dispenser, when originally instituted, did not refer to the attempted service in California, the motion became supplemented and amplified before being heard, into a motion broad enough to include a motion to quash attempted service in New York or California on the basis of the issues raised by Bobrick.

Although American Dispenser did not file its motion until more than twenty days after attempted service on American Dispenser in California, there is no waiver of venue resulting therefrom, because venue cannot be "waived in a forum in which an action has not and could not have been properly brought by the opposing party". *Behimer v. Sullivan,* 261 F. 2d 467, CCA7. In *Kadet-Kruger & Co. v. Celanese Corporation of America,* 216 F.Supp. 249, N.D. Ill. E.D., three months after entry of a default, defendant moved to quash defective service. The court, in vacating the default order, held that the twenty day period for answering did not begin to run "until service had been effected in a legally permissible manner".

Also, assuming, *arguendo,* that there was a technical default here, Judge Westover has refused to enter such a default. Under Rule 55(c) of the Federal Rules of Civil Procedure, the District Court can set aside a default for good cause. The "grant or denial of a motion for the entry of a default judgment is within the discretion of the court". *Lau Ah Yew v. Dulles,* 236 F. 2d 415, CCA9.

II.

JURISDICTION OF THE DISTRICT COURT OVER THE PERSON OF AMERICAN DISPENSER IS NOT DEPENDENT ON THE LAW OF THE STATE OF CALIFORNIA.

Bobrick in its brief on page 8, states that Rules 4(d)-(3) and 4(d) (7) of the Federal Rules of Civil Procedure, are applicable to the question of the propriety of service and contends that under these Rules, the service is sufficient if the summons and complaint are served in the manner prescribed by the California Code of Civil Procedure. Then it proceeds to quote most profusely on seven pages of the brief from the state decision of *Cosper v. Smith & Wesson Arms Co.*, 53 Cal. 2d 77 in an attempt to prove that service on the general manager of the defendant operating in a certain manner in the State of California was good service. Bobrick is in error in its method of rationalization and in the relevancy it attributes to this case.

The Patent Statutes specifically provide the conditions under which an alleged infringer is amenable to the process of a federal court. Whether such an infringer was present or doing business within the state so as to make it amenable to the process of this court is a question of substantive law to be decided solely by the decisions of the Federal Courts. 28 U.S.C. 1400(b) provides:

> "Any civil action for patent infringement may be brought in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business."

This Statute, in effect, indicates when a foreign corporation in a patent infringement suit is considered to be doing business in a district, so as to make it amenable to the process of a federal court in that district. 28 U.S.C. 1694 provides:

> "In a patent infringement action commenced in a district where the defendant is not a resident but has a regular and established place of business, service of process, summons or subpoena upon such defendant may be made upon his agent or agents conducting such business".

And Rule 82 of the Federal Rules of Civil Procedure holds that the rules of Civil Procedure

> "shall not be construed to extend or limit the jurisdiction of the United States district courts or the venue of actions therein".

In *Jacobowitz v. Thomson,* 141 F. 2d 72, 75, CCA2, it was held that validity of service under federal statutes is a matter of federal law and in *Favell-Utley Realty Co. v. Harbor Plywood Corp.,* 94 F.Supp. 96, N.D. Cal., S.D., it was held that Rule 4 (d) (7) is of no assistance unless constitutional and federal statutory standards have been met. In *Singleton v. Atlantic Coast Line R. Co.,* 20 F.R.D. 15, D.C. Mich., it was held that where a federally-created right is being asserted in a federal court, federal law governs as to whether a foreign corporation is doing business within the district in which that federal court is sitting so as to be amenable to service of process within the district. To the same effect, see also *Bar's Leaks Western, Inc. v. Pollock,* 148 F.Supp. 710, D.C. Cal. And in *B. Heller & Co. v.*

First Spice Manufacturing Corp., 172 F.Supp. 46, N.D. Ill, E.D., it was held:

> "However, in patent infringement cases, Rule 4 of the Federal Rules of Civil Procedure, 28 U.S.C., should not be construed to extend or limit the jurisdiction or venue of the district courts."

It is submitted, therefore, that Federal Rules 4 (d)-(3) and 4 (d) (7) only refer to the method of service and presuppose that the foreign corporation is amenable to suit in the state. Whether state standards or federal law concepts are to be applied in determining the amenability of a foreign corporation to suit in a state depends on whether state or federal-created law is being asserted.

The case of *Cosper v. Smith & Wesson Arms Co.*, 53 Cal. 2d 77, so heavily relied on by Bobrick in its brief, indicates that the validity of service under Federal Rules depends not only on whether "the person served is within the statutory designation here 'the general manager in this state' " but *also* "on whether the foreign corporation is 'doing business in this state' within the meaning of the Statute" (p. 82 not quoted by Appellant). Since the Federal Statute 28 U.S.C. 1400(b) has provided, in effect, that in a patent infringement suit, a foreign corporation, for the purpose of jurisdiction, is considered to be "doing business" in a district when the corporation has "a regular and established place of business" in the jurisdiction, the application of the criteria of "doing business" set forth in *Cosper v. Smith & Wesson Arms Co.* cannot be applied to the instant patent infringement suit. In *Cosper v. Smith & Wesson Arms Co.*, the plaintiff, a police officer, brought action for personal injuries allegedly

sustained in the State of California, when the cylinder of a revolver purchased by him in the State from the defendant and manufactured by the defendant, exploded and blew a part during target practice. No federal question of law was involved there, and the presence of the defendant corporation in California was therefore determined in accordance with the law of California.

Even under the laws of the State of California, Philip Shore is not an agent of American Dispenser for the service of summons in the State of California under the decision in *L. D. Reeder Contractors of Ariz. v. Higgins Industries*, 265 F. 2d 768, CCA9.

Bobrick, in its attempt to bring the instant case within the ambit of the California case of *Cosper v. Smith & Wesson Arms Co.*, makes statements in its brief which are not supported by the record or which may raise implications not based on facts. For example, on the bottom of page 14 of its brief, it states that "American admits that Shore-Robertson sells substantially quantities of its products in California". No such admission is found in the records. If any products of American Dispenser are sold in California, they are *not* sold by American Dispenser but are sold by Shore-Robertson as owner of these products and on its own behalf [TR 29, lines 7-23; TR 83, 84 and 85 and Exhibits A, B and C]. All sales by American Dispenser to Shore-Robertson are consummated in New York. American Dispenser has not made, used or sold any Soap Dispensers in California and therefore, has *not* infringed any of Bobrick's patents in California.

Bobrick on top of page 15 of its brief, states that "the infringing sale occurred in this State (Califor-

nia)". If there were any infringing sales, they were made by Shore-Robertson as the owner of the products it brought outright in New York from American Dispenser and *not* by American Dispenser.

Also, Bobrick on page 15 of its brief, states that "the District Court abused its discretion by deciding the question without permitting discovery and a hearing". Bobrick had its hearing and in its briefs in opposition to the motion did raise the question of default and did make a request for entry of judgment or default. The discovery to determine the question of whether or not American Dispenser has a regular and established place of business, was comprehensive enough to determine the capacity of Philip Shore as agent of American Dispenser to receive process on its behalf. Moreover, Bobrick's attorney *approved* the order of Judge Westover granting it the right of discovery on the issue of whether American Dispenser has committed acts of infringement and has a regular and established place of business within the Southern Judicial District of California [TR 55], notwithstanding the fact that in its opposition, filed January 14, 1965, to the motion, it had opposed the motion as being too late [TR 34, line 30] and on January 11, 1965 it had filed a Request to Enter Default [TR 103]. Under these conditions, Bobrick is *estopped* from asserting that it has been deprived of the right of discovery on the issue of jurisdiction.

Bobrick, still careless with the facts, states on top of page 15 of its brief that "plaintiff is a California Cor-

poration". Bobrick is a Delaware Corporation [TR 7, lines 23 and 24] and American Dispenser is a New York Corporation. The trial would be more convenient for the parties in Delaware where the Declaratory Judgment Suit against Bobrick has been brought, and near where the products of American Dispenser are located.

Bobrick on page 15 of its brief, cites and quotes from *Orange Theatre Corp. v. Rayherstz Amusement Corp.*, 130 F. 2d 185, CCA3, where the case was remanded for further proceedings on the question of default. That case is not applicable here. In that case, there had been stipulations extending time for answer, and the District Court, under a misunderstanding of the law, had considered these stipulations sufficient to avoid default. The appeal court held otherwise, and remanded the case back to the District Court to determine the question of default on the basis of the correct legal premise that stipulations extending time were ineffective in avoiding defaults. Based on proper legal premise, the District Court might have held the default sufficient to justify denial of defendant's motion based on improper venue.

In the case at bar, Judge Westover has already decided the question of default from the facts available to him, and for good cause, has refused to enter judgment on default. The issue has already been fully considered and a decision rendered thereon, and a remand would still result in dismissal of the action against American Dispenser. Remand, therefore, to the District Court in this case would be a futile gesture, since in

the exrecise of its discretion and also for good cause, the default would be set aside on motion.

It is interesting to note in connection with the case of *Orange Theatre Corp. v. Rayherstz,* relied upon by Bobrick, that after the remand, the district court *again* granted the defendant's motion for dismissal and the plaintiff again appealed. This time, the Court of Appeals, in 139 F. 2d 871, CCA3, in affirming the District Court's order of dismissal, said:

> "For if the extraterritorial service upon the individual defendants was unauthorized and invalid it did not confer upon the district court the power to adjudicate the controversy between the parties. Munter v. Weil Corset Co., 1923, 261 U.S. 276, 43 S.Ct. 347, 61 L.Ed. 652. The individual defendants were, therefore, entitled to ignore the whole proceeding and subsequently attack any default judgment which might result from it. Butterworth v. Hill, 1886, 114 U.S. 128, 5 S.Ct. 796, 29 L.Ed. 119. Under such circumstances the district court could acquire the power to adjudicate the controversy only if the parties voluntarily appeared. Consequently the failure of the individual defendants to assert the defense of lack of jurisdiction of their persons could not at any time before their voluntary appearance fairly be treated as a waiver of the defense nor could the twenty day period prescribed by Rule 12 for serving a motion or answer raising the defense commence to run prior to such appearance."

III.

VENUE IS IMPROPER.

Bobrick, in its brief, tries to dodge the consequences of improper venue by reliance on alleged default arising from improper service of process. It is significant that Bobrick, nowhere in its brief, argues that there is proper venue in this case. Since Bobrick is the appellant, American Dispenser would be justified by the absence of such arguments to dispense with a discussion of the question of proper venue. However, since the issue of whether American Dispenser has a regular and established place of business in California will also decide whether Philip Shore is an agent of American Dispenser for the service of summons in the State of California, a discussion of this question of venue is submitted herein.

Fourco Glass Co. v. Transmirra Products Corp., 352 U.S. 222, 77 S.Ct. 787, held "that 28 U.S.C. 1400(b) is the sole and exclusive provision controlling venue in patent actions". Therefore, to support proper venue, Bobrick must plead and prove:

> (1) that the American Dispenser resides in the Southern Judicial District of California, *or*
>
> (2) that American Dispenser has committed acts of infringement in that district *and* has a regular and established place of business in that district.

The two requirements under (2) are in the conjunctive and the "absence of either circumstance is fatal". *Endrezze v. Dorr,* 97 F. 2d 46, CCA9.

Furthermore, the burden of proving the "jurisdictional facts" is on Bobrick and any doubts should be resolved against Bobrick. *Phillips v. Baker,* 121 F. 2d 752, CCA9.

Here, there has been no infringement in California by American Dispenser under the holdings in *Endrezze v. Dorr Co. Inc.,* 97 F. 2d 46, CCA9; *Marlatt v. Merganthaler Linotype,* 70 F.Supp. 426, S.D. Cal.; *Kamkap Inc. v. Worldbest Industries,* 140 F.Supp. 854, S.D. N.Y., and *Minnesota Mining & Mfg. Co. v. International Plastic Corp.,* 159 F. 2d 554, CCA7. The affidavits of Feinson [TR 29, lines 7-23; TR 83, 84 and 85 and Exhibits A, B and C], indicate that under these decisions, American Dispenser has not committed any acts of infringement in the Southern Judicial District of California; that should dispose of the question of venue in California. In addition, American Dispenser does *not* have a regular and established place of business in California as the facts under the heading CONCISE STATEMENT OF PERTINENT FACTS herein indicated. On this issue, *Phillips v. Baker,* 121 F. 2d 752, CCA9, held:

> "* * * before a foreign corporation subjects itself to jurisdiction in a patent suit, it must appear that it is 'engaged in carrying on in a continuous manner a substantial part of its ordinary business' within the district in which action is brought * * * In order to bring itself within the jurisdiction of a court of a particular district, by force of the statute the defendant firm (a) must have a place of business in the district; (b) that place of business must be 'regular'; and (c) it must be 'established'."

Bobrick, during the course of the motion of American Dispenser through the lower court, attempted to prove proper venue based on the facts that (1) American Dispenser had its name on the front of the building in Los Angeles, California and received mail there,

(2) American Dispenser was listed in the Los Angeles telephone directory, (3) American Dispenser advertised the "Western Sales Office" as being located in Los Angeles, and (4) American Dispenser had a booth at the NSSA West Coast Trade Show in Los Angeles. Bobrick also relies on these facts in its brief on pages 4 and 5 to show that Philip Shore was an agent of American Dispenser for service of process.

The listing by a defendant of a name on the front of a building in a judicial district and a listing in the telephone directory in the judicial district does not indicate that the defendant has a regular and established place of business in that judicial district. The listing here in the telephone directory was made at the expense of Shore-Robertson without consulting American Dispenser [Dep. pp. 54, 58] and the name of American Dispenser was placed on a sign at the address of Shore-Robertson, in conjunction with those of other firms without the consent of American Dispenser [Dep. pp. 27, 28, 30.]

The authorities support the position of American Dispenser. In *Wilson v. McKinney Mfg. Co.*, 59 F. 2d 332, CCA9, it was held on this issue:

> "Advertising, good will operations, maintenance of an office, listing its name in the telephone directory, or having its name on a door, while material, do not necessarily constitute 'doing business'."

In *General Radio Company v. Superior Electric Company*, 293 F. 2d 949, CCA1, the facts and decision were recited as follows:

> "Superior displays its name on the door of its Massachusetts sales office on the directory in the

main hallway of the building in which its office is located and on the outside of the building itself. Its name and address are listed in the local telephone directory and also the Yellow Pages carrying advertising.

On these facts we think the court below correctly dismissed the plaintiff's complaint for lack of venue insofar as it claims patent infringement."

The case *W. S. Tyler Co. v. Ludlow-Saylor Wire Co.*, 236 U.S. 723, 35 S.Ct. 458, 59 L.Ed. 808, is still cited as a leading case in the field. In that case, the defendant foreign corporation maintained an office and secretary in New York, sharing the rent and salary expenses with another corporation. A salesman was paid salary, commission and expenses; he had authority to solicit purchase orders within the state, but could not complete sales. The corporation listed itself in the New York telephone directory and on the office door. It also advertised itself as having a New York office and had samples on display in its New York office. The court held that under this state of facts, venue did not lie in New York.

In *Knapp-Monarch Co. v. Casco Products Corp.*, 342 F. 2d 622, CCA7, on this issue, the court in relying on *W. S. Tyler Co. v. Ludlow-Saylor Wire Co. (supra)*, said:

"Initially, we hold that Casco's maintaining a sales representative in Chicago does not meet the statutory test. * * *

The fact that Casco had its name listed on the building directory where Langenfeld had its office

> is not determinative when we are mindful that Casco paid none of Langenfeld's expenses, had no employees in the latter's office, and exercised no control over its operation."

And in *Brevel Products Corp. v. H&B American Corporation,* 202 F.Supp. 824, S.D. N.Y., the defendant, a California concern, maintained a New York telephone number; its name appeared on the building directory and on portions of the door of the Ross-Bornemann Associates, independent contractors working for the defendant on a commission basis and acting as sales representatives in the New York area for many product manufacturers; defendant's catalog listed the address of Ross-Bornemann Associates in New York as its "New York sales and show-room". The Court held that the "foregoing facts are insufficient to sustain venue in this district (New York) under 28 U.S.C. Sec. 1400-(b)".

The general law regarding the effect of a distributor or sales representative in determining the question of venue is also followed in the determining the sufficiency of service of process under Rule 4 of the Federal Rules of Civil Procedure. *Moore's Federal Practice,* Vol. 2, Second Edition p. 1122 *et seq.* under the heading SERVICE UNDER RULE 4 (d) (3), states:

> "The term 'a managing or general agent' apparently refers to a person of authority and responsibility in the organization's operations in the place where service is made."

Philip Shore has no position of any kind in American Dispenser.

Also, *Moore,* in this connection, says further

> "* * * ordinarily an independent distributor or sales organization is not considered the agent for the acceptance of service upon organization in whose products it deals, unless it is shown that the production organization so controls the distribution or sales organization that it is proper to consider it the agent of the production organization."

As to the contention of Bobrick that American Dispenser advertised its Western Sales Offices as being at 7701 E. Compton, it should be noted that in *all* of these advertisements, the name of "Philip Shore & Associates" was indicated in connection with this address. American Dispenser was merely referrring to Philip Shore & Associates as an organization from which the products of American Dispenser could be purchased.

Bobrick also grasps at the fact that there was a display of the goods of American Dispenser at the NSSA West Coast Trade Show in Los Angeles, to show that American Dispenser had a regular and established place of business in Los Angeles. Although the goods of American Dispenser were displayed at the Trade Show, the booth was that of Shore-Robertson, paid entirely by latter firm [Dep. pp. 39, 41] and staffed by its own salesmen [Dep. p. 42].

Authorities hold that the display of goods at a Show in a district by a defendant does not indicate that the defendant has a regular and established place of business in the district. On this issue, the case of *Knapp-Mon-*

arch Company v. Casco Products Corp. et al., 342 F. 2d 622, CCA 7 (*supra*), is in point. There, the Court held:

> "We next consider Casco's participation in the Housewares Shows. Although the show itself may have been a semiannual event and thus 'regular' in that sense, Casco's participation in it constituted a temporary presence in Chicago rather than a regular and established place where one could transact business with the defendant from day to day and from month to month. Moreover, as the court pointed out in B. Heller & Co. v. First Spice Mfg. Corp., 172 F.Supp. 46, 121 USPQ 568 (D.C. Ill. 1959), where a similar question was presented, 'the (trade) organizations need not have an annual trade show, they need not hold it within this district, they need not rent space to defendants * * * since these factors are removed from defendants' control, it cannot be said that defendants have a 'regular and established' place of business within this district.' Similarly, Casco did not have that degree of control over the Housewares Shows for it to have there an established place of business, that is one of a permanent or settled character."

To the same effect, see *Mastanuono v. Jacobsen Manufacturing Company,* 184 F.Supp. 178, S.D. N.Y., and *New Wrinkle, Inc. v. Fritz et al.,* 30 F.Supp. 89, W.D. N.Y.

The Declaratory Judgment Action filed in Delaware against Bobrick gives Bobrick an opportunity to quickly litigate all issues involved in the instant suit between it and American Dispenser in a jurisdiction where the

question of jurisdiction and venue cannot arise. Bobrick has failed to stay the action in Delaware and that action will proceed along its normal course. In *Phillips v. Baker,* 121 F. 2d 752, CCA9, the Court in granting a motion to dismiss for lack of proper venue, considered it "better that the parties be remitted to the district where there is no doubt as to the jurisdiction". And in *Harris-Intertype Corp. v. Photon, Inc. et al.,* 185 F. Supp. 525, S.D. N.Y., the Declaratory Judgment Action was filed in Massachusetts fifteen (15) days after filing in New York. The Court in dismissing the bill because the defendant had no regular and established place of business, said:

> "It is to be observed that the controlling issues in this patent litigation can be fully, effectively, and expeditiously adjudicated in the District of Massachusetts."

CONCLUSION.

For the many reasons indicated above, the Court is respectfully urged to affirm the judgment of the District Court.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Charles E. Wills

NO. 20101

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE BOBRICK CORPORATION,

Appellant,

vs.

AMERICAN DISPENSER CO., INC.,

Appellee.

APPELLANT'S REPLY BRIEF

APPEAL FROM
UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF CALIFORNIA
CENTRAL DIVISION

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CONCISE STATEMENT OF PERTINENT FACTS

Appellee repeatedly states that, prior to the expiration of the time to answer, it had no knowledge of the service on it on November 12, 1964 in the Southern District of California. For example, on page 5 of its Brief, American states:

> "It is apparent from the foregoing facts that American Dispenser had no knowledge of any attempted service on it in California through Philip Shore."

The "foregoing facts" is a mere statement in a Memorandum of American Dispenser prepared by their local attorneys who may have honestly believed the statement to be true because of a lack of information. Whether American knew that it had been served in Los Angeles

on November 12, 1964 is a question that undoubtedly will be gone into if American moves to set aside its default for "good cause" under Rule 55(c) of the Federal Rules of Civil Procedure. But, the question has not been gone into yet and there is absolutely no evidence in the record pertaining thereto -- only the self-serving statements of counsel. Perhaps discovery will later show that the statements are true, but this Court on this record should not allow its decision to be colored by these unsworn, and perhaps erroneous, statements.

Also on page 5 of its Brief, American apparently argues that it was not in default as long as Bobrick did not make a request for entry or judgment of default and, since American filed its motion to quash service and dismiss for lack of proper venue on January 6, 1965, prior to Bobrick's Request to Enter Default, filed on January 11, 1965, the Request was too late. American also intimates that Bobrick followed the wrong procedure in directing the Request to the "Clerk" under Rule 55(b)(1) instead of the "Court" under Rule 55(b)(2). American is wrong on all counts. First, a party is in default when the twenty days to answer expires; entry of default is a purely formal matter. Orange Theatre Corp. v. Rayherstz Amusement Corp., 130 F.2d 185, 6 FR Serv. 66.12, Case 1 (3rd Cir. 1942). Second, Bobrick did not proceed under Rule 55(b)(1), which relates to "judgment by default" by the Clerk. Bobrick proceeded under Rule 55(a) to have the Clerk "enter" the default. This is "the first step leading to the entry of a judgment of default". 6 Moore's Federal Practice, Para. 55.03(1), page 1809 and Para. 55.02(3), page 1807. Bobrick did not apply to the Court for a judgment by default under Rule 55(b)(2)

because there were several remaining defendants who were jointly liable with American. In such a case "entry of judgment should await an adjudication as to the liability of the non-defaulting defendants". 6 Moore's Federal Practice, Para. 55.06, page 1820.

On page 6 of its Brief, Appellee states that: "Bobrick raised no objections to the (discovery) order and indicated its approval thereof by the approved signature of its attorney on the proposed order." The reason is crystal clear: Appellee had not raised the issue of jurisdiction over its person arising out of service in the Southern District of California, and Bobrick believed the issue had been waived under Rules 12(g) and (h) on January 6, 1965 when Appellee filed its Rule 12 Motion. Why should Bobrick have insisted on discovery into matters not then in issue? Appellee then proceeds, on page 6, to state that Bobrick could have exceeded the scope of the discovery order since Appellee would not have objected. This knowledge comes a little late but, in any event, Bobrick had no way of knowing when it took the deposition of Shore on March 2, 1965, that the issue of jurisdiction over the person arising out of service in California would suddenly and unexpectedly later arise, as it did, in the Court's order of April 8, 1965.

Moreover, even if Bobrick had been clairvoyant and had gone into the question of whether Philip Shore was an "agent" of American, under Rule 4(d)(3), that would not have wholly disposed of the issue of jurisdiction over the person because under California law, made applicable by Rule 4(d)(7), jurisdiction over the person may be obtained if service is made on "the general manager in this

State". See California Code of Civil Procedure, Section 411 (2); California Corporations Code, Section 6500.

SUMMARY OF ARGUMENT

1. American Dispenser waived its right to have the action against it dismissed on the ground that the Court did not have jurisdiction over its person arising out of service in California.

2. Jurisdiction of the District Court over the person of American Dispenser is dependent on the law of the State of California.

3. American may not move to dismiss under Rule 12 for improper venue until it sets aside the default.

ARGUMENT

1. American Dispenser Waived Its Right to Have the Action Against It Dismissed on the Ground That the Court Did Not Have Jurisdiction Over Its Person Arising Out Of Service in California.

American was in default and had no standing to challenge jurisdiction over its person arising out of service in California. But, even if it did have standing, it waived its defense when it filed its Rule 12 Motion as pointed out in Appellant's Brief, pages 6-7.

On page 12 of its Brief, Appellee talks about "no showing that Philip Shore was a proper person for service as an agent of American Dispenser" and "no showing" of other things, implying that the burden of proof on the issue of jurisdiction over the person

was on Bobrick. Like Appellee, Bobrick has found no cases in point. However, jurisdiction over the person is similar to venue in these respects: Jurisdiction over the person need not be alleged in the Complaint. See Explanatory Note to Official Form 2 in Appendix to the Federal Rules of Civil Procedure. And, jurisdiction over the person may be waived. Rules 12(g) and (h) of the Federal Rules of Civil Procedure; 1A Federal Practice and Procedure by Barron and Holtzoff, Section 370, pages 509-510. So, the burden of proving lack of jurisdiction over the person, like the burden of proving lack of venue, should be on the moving party.

American also argues, on page 13, that the issue of default was before the District Court. This is wholly unrealistic procedurewise. Appellee made no motion to set aside the default under Rule 55(c) either in writing or orally during hearing, as required by Rule 7(b). But, see Local Rule 3(i) which states: "No oral motions . . . will be recognized." Clearly, then, the party seeking to set aside a default "should make a formal motion". 6 Moore's Federal Practice, Para. 55.10 (1), page 1828. And, the motion "must state with particularity the grounds therefor". 1/ 2 Moore's Federal Practice, Para. 7.05, page 1542. Not having done so, the issue of default was not before the Court. And, even if it were, it was not wholly disposed of, as previously pointed out, because the Court made no finding on whether Philip Shore was

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1/ Bobrick therefore disagrees with Appellee's statement on page 14 that: "There are no prescribed Rules in the Federal Rules of Civil Procedure regarding the form in which a motion must be brought."

"the general manager in this State".

2. Jurisdiction of the District Court Over the Person of American Dispenser is Dependent On the Law of the State of California.

Appellee heads Part II of its Brief as follows: "Jurisdiction over the person of American Dispenser Company is not dependent on the law of the State of California". Yet, Rule 4(d)(7) of the Federal Rules of Civil Procedure provides that service may be made upon a domestic or foreign corporation:

> " . . . in the manner prescribed by the law of the State in which the district court is held. . . . "

Service of original process is "the means of securing jurisdiction by the court over the defendant's person". 2 Moore's Federal Practice, Para. 4.02(4), page 954. So, Bobrick does not understand Appellee's argument, especially the reference to 28 U.S.C. Section 1400(b), which is in Chapter 87 of Title 28, entitled "Venue". Venue and jurisdiction over the person are not the same thing, and neither has any bearing on the other. As stated in 2 Moore's Federal Practice, Para. 4.02(4), page 955:

> "There often may be situations where venue is proper in a place where service of process may not be obtained over defendant and contrariwise there may be situations where service is proper but venue is lacking.".

If Appellee is arguing that 28 U.S.C. Section 1694, made applicable by Rule 4(d)(7), is the exclusive means of serving process in a patent infringement action, Appellee cites no authority therefor. Such an argument would be contrary to the alternative "or" in Rule 4(d)(7) and the non-mandatory "may" in Section 1694.

Bobrick agrees that Appellee must have certain minimal contacts with the State of California to satisfy the Constitutional due process requirements. McGee v. International Life Insurance, 355 U.S. 220 (1957). If this is what Appellee means by "federal law", then the California Court applied federal law in Smith & Wesson, saying (at page 12 of Appellant's Brief):

> "Certainly, the admitted activities of Smith and Wesson in this state are more significant than the minimal contacts deemed sufficient in McGee v. International Life Ins. Co., 355 U.S. 220, 78 S. Ct. 199, 2 L. Ed. 2d 223, where the foreign corporation elected to deal with its insured, a California resident, only by mail."

3. American May Not Move to Dismiss Under Rule 12 For Improper Venue Until it Sets Aside the Default.

In Orange Theatre v. Rayherstz Amusement, 130 F. 2d 185, 6 FR Serv. 66.12, Case 1 (3rd Cir. 1942), the Court held that a party may not move to dismiss for improper venue until it sets aside the default. American says, on pages 21-22, that remand

would be a "futile gesture" since the Court would set aside the default for good cause. Perhaps so, but Bobrick wants a hearing on that issue. Bobrick wants to know what Philip Shore did with the service on American of the Summons and Complaint. Bobrick wants the Court to determine if Philip Shore was the "general manager in this State" within the meaning of Smith & Wesson, because Bobrick has never had an opportunity to argue this point since the issue of jurisdiction over the person was not raised until Appellee gratuitously inserted it in their proposed order after hearing. Suppose that further discovery reveals that Philip Shore immediately forwarded the Summons and Complaint to American. Suppose that after reading Smith & Wesson and permitting discovery on the relevant factors considered therein, the Court decides that Philip Shore was "the general manager in this State". In that event, Bobrick doubts that remand would be a "futile gesture". Rather, the Court would probably refuse to set aside the default and Bobrick could move for a default judgment when and if it were successful against the other defendants, thereby making it desirable for American to defend said other defendants, who are American's customers, and perhaps prevent American from carrying out its scheme to make Bobrick simultaneously litigate the infringement of the same patent by the same device in both California and in Delaware.

CONCLUSION

American defaulted and was without standing to move to dismiss for either lack of venue or lack of jurisdiction over its person.

[illegible]

Nevertheless, without moving to set aside the default, American did move to dismiss for lack of venue and lack of jurisdiction over its person arising out of service in New York, thereby waiving any objection to the service on it in California under Rules 12(g) and (h) of the Federal Rules of Civil Procedure. After hearing on these issues, in which it prevailed, American gratuitously inserted a provision in its proposed order that "the Court does not have jurisdiction over the person of American Dispenser because Philip Shore is not an agent thereof for the service of summons in the State of California", as required by Rule 4(d)(3) of the Federal Rules of Civil Procedure. In attempting to "fix up" the order to invalidate the previously waived service in California, American apparently forgot that service could also be made under Rule 4(d)(7) on "the general manager in the State". So, even if American's whole questionable procedure is stamped with approval, it cannot prevail because jurisdiction over its person was obtained by service on its "general manager in this State", as that term is defined by the California Courts. Having then defaulted, American's attempt to move to dismiss for lack of venue was without effect under the Orange Theatre decision. The case should therefore be remanded to determine if there is "good cause" under Rule 55(c) to set aside the default.

Respectfully submitted,

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THOMAS P. MAHONEY

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The Bobrick Corporation

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Thomas P. Mahoney
THOMAS P. MAHONEY

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BRIEF OF APPELLANT THE BOBRICK CORPORATION

STATEMENT OF PLEADINGS AND JURISDICTIONAL FACTS

The complaint alleges a cause of action for patent infringement against AMERICAN DISPENSER CO. and others (Tr. 2-4). The District Court had jurisdiction of the subject matter under 28 U.S.C. Section 1338(a).

The District Court entered a final order dismissing the action against AMERICAN DISPENSER CO. for lack of venue and jurisdiction over the person (Tr. 101-102). Plaintiff THE BOBRICK CORPORATION filed a timely Notice of Appeal (Tr. 108). This Court has jurisdiction to review the final order under 28 U.S.C.

Sections 1291 and 1292(4).

STATEMENT OF THE CASE

The complaint alleges a cause of action for patent infringement against AMERICAN DISPENSER COMPANY, BURTON L. FEINSON, the Treasurer and General Manager of AMERICAN DISPENSER COMPANY, and SHORE-ROBERTSON & ASSOCIATES, a co-partnership consisting of PHILIP SHORE and DAVID ROBERTSON (Tr. 2-4).

On November 12, 1964, the United States Marshal for the Southern District of California served the summons and complaint on AMERICAN DISPENSER COMPANY in Los Angeles by handing to and leaving true and correct copies with PHILIP SHORE, who plaintiff contends was AMERICAN's agent for service of process. 1/

At the same time, the United States Marshal for the Southern District of California served SHORE-ROBERTSON & ASSOCIATES in Los Angeles by handing to and leaving true and correct copies with PHILIP SHORE.

Also on November 12, 1964, the said United States Marshal served PHILIP SHORE individually.

On December 17, 1964, the United States Marshal for the

1/ The returns of service on all relevant defendants were omitted from the Transcript of Record. The parties have subsequently filed supplemental designations covering the returns on AMERICAN DISPENSER COMPANY, SHORE-ROBERTSON & ASSOCIATES, PHILIP SHORE and BURTON FEINSON.

Southern District of New York served BURTON L. FEINSON in New York.

AMERICAN defaulted on December 2, 1964 by failing to file an answer within twenty (20) days as required under Rule 12(a) of the Federal Rules of Civil Procedure.

On December 17, 1964, AMERICAN filed a declaratory judgment action on the same patent against the BOBRICK CORPORATION in Delaware (Tr. 31-32).

Later, on January 6, 1965, AMERICAN and BURTON L. FEINSON moved in California for an order "that the return of service of summons upon the defendant BURTON L. FEINSON and/or AMERICAN DISPENSER COMPANY, INC. in New York City be quashed for lack of jurisdiction over the person, and that this action be dismissed as to said defendants BURTON L. FEINSON and AMERICAN DISPENSER COMPANY, INC. for improper venue" (Tr. 11-12).

The Court dismissed the action against FEINSON and permitted the following limited discovery on the issue of venue under 28 U.S.C. Section 1400(b):

> "The plaintiff THE BOBRICK CORPORATION may proceed with discovery on the issue of whether AMERICAN DISPENSER COMPANY, INC. has committed acts of infringement and has a regular and established place of business within the Southern Judicial District of California." (Tr. 55.)

On April 8, 1965, the Court entered a final Order as follows:

> "IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Defendant's motion is granted and the action against AMERICAN DISPENSER COMPANY, INC. is dismissed on the grounds that the Court does not have jurisdiction over the person of AMERICAN DISPENSER COMPANY, INC. because PHILIP SHORE is not an agent thereof for the service of summons in the State of California, and venue for patent infringement does not lie in this Judicial District under Section 1400(b) of Title 28, United States Code, because AMERICAN DISPENSER COMPANY, INC. does not reside in this Judicial District nor does it have a regular and established place of business therein." (Tr. 101-102).

The facts showing that PHILIP SHORE was an agent of AMERICAN for service of process, so far as known by plaintiff, are as follows:

AMERICAN now has its name on the front of the building at 5401 South Santa Fe Avenue in Los Angeles, California, the office of PHILIP SHORE & ASSOCIATES (Tr. 43; Dep. 29 [2/]). AMERICAN receives mail at this address (Dep. 28-29).

AMERICAN is listed in the Los Angeles Telephone Directory and the Yellow Pages thereof under a former address, 7701 E.

2/ Reference is to page 29 of the Deposition of PHILIP SHORE taken on March 2, 1965.

Compton in Paramount, California (Tr. 44-45). This address and telephone number was the same as PHILIP SHORE & ASSOCIATES (Dep. 55-56).

From November 1960 to October 1964, AMERICAN advertised 7701 E. Compton as its "WESTERN SALES OFFICE" (Dep. 27 and Dep. Exhibits 5-D, 5-E, 5-F, 5-I, 5-J, 5-K and 5-L). AMERICAN also received mail at this address (Dep. 28).

From April 1956 to November 1960, AMERICAN advertised 2881 E. Pico Boulevard, Los Angeles, California as its "WEST COAST SALES OFFICE" (Dep. Exhibits 3, 4, 5-A, 5-B, 5-C). This was also the address of PHILIP SHORE & ASSOCIATES (Dep. 48).

AMERICAN had a booth at the NSSA West Coast Trade Show in Los Angeles on October 24 and 25, 1964 (Dep. Exhibit 2). Mr. BURTON FEINSON, the General Manager of AMERICAN, was in the booth and SHORE-ROBERTSON took orders there (Dep. 42).

There are undoubtedly many more similar facts of which plaintiff is not aware because, as previously pointed out, the Court prohibited discovery on the issue of jurisdiction over the person.

SPECIFICATION OF ERRORS

1. The Court erred in dismissing the action against AMERICAN DISPENSER COMPANY, INC. for lack of jurisdiction over the person.

2. The Court erred in dismissing the action against

AMERICAN for lack of venue.

SUMMARY OF ARGUMENT

1. AMERICAN did not move to dismiss for lack of jurisdiction over its person arising out of the service on PHILIP SHORE in California. AMERICAN thereby waived any objection to such jurisdiction.

2. AMERICAN defaulted by not answering the complaint within twenty (20) days. It therefore had no standing to challenge venue.

ARGUMENT

I

AMERICAN WAIVED JURISDICTION OVER ITS PERSON ARISING OUT OF SERVICE IN CALIFORNIA.

The law is clear that jurisdiction over the person may be waived. IA Federal Practice and Procedure by Barron and Holtzoff, Section 370, pp. 509-510.

AMERICAN moved under Rule 12 of the Federal Rules of Civil Procedure to dismiss for lack of venue and lack of jurisdiction over its person arising out of service on FEINSON in New York City; AMERICAN did not move to dismiss for lack of jurisdiction over its person arising out of service on PHILIP SHORE in Los Angeles. AMERICAN thereby waived its objections to service in Los Angeles

under Rule 12(g) and (h) of the Federal Rules of Civil Procedure as follows:

> "(g) CONSOLIDATION OF DEFENSES. A party who makes a motion under this rule may join with it the other motions herein provided for and then available to him. If a party makes a motion under this rule and does not include therein all defenses and objections then available to him which this rule permits to be raised by motion, he shall not thereafter make a motion based on any of the defenses or objections so omitted. . . .
>
> "(h) WAIVER OF DEFENSES. A party waives all defenses and objections which he does not present either by motion as hereinbefore provided or, if he has made no motion, in his answer or reply, . . ."

AMERICAN attempted to rectify this waiver in the Order, prepared by it under Local Rule 7(a), which states, as previously set forth, that "the action against AMERICAN DISPENSER COMPANY, INC. is dismissed on the grounds that the Court does not have jurisdiction over the person of AMERICAN DISPENSER COMPANY, INC. because PHILIP SHORE is not an agent thereof for the service of summons in the State of California". So, AMERICAN succeeded in having the action dismissed on grounds it had waived and without making a motion directed to said grounds. Worst of all,

AMERICAN got the action dismissed without plaintiff having had any discovery on the issue of jurisdiction over the person, which involves several provisions of the Federal Rules of Civil Procedure, as well as State Law. Rule 4(d)(3) provides that service shall be made upon a foreign corporation by delivering a copy of the summons and complaint to "a managing or general agent, or to any other agent authorized by appointment to receive service of process". Rule 4(d)(7) provides that it is also sufficient if the summons and complaint are served in the manner prescribed "by the law of the State in which the District Court is held". This, in turn, requires application of the California Code of Civil Procedure Section 411(2), which provides that a summons must be served on a foreign corporation in the manner provided in the Corporations Code. Section 6500 of the Corporations Code says that a foreign corporation may be served by delivery by hand of a copy of the process to "the general manager in this State".

In Cosper v. Smith & Wesson Arms Co., 53 Cal.2d 77, 346 P. 2d 409 (1959), the California Supreme Court held that service on a manufacturer's representative was sufficient. The Court there said:

> "Plaintiff claims that the admitted activities of Smith and Wesson in this state establish that it was 'doing business' here so as to be amenable to the service of process, and that proper service was effected upon it by serving Lookabaugh. He further contends that the court's contrary findings are not

supported by the evidence but constitute only erroneous conclusions of law. The single affidavit filed in support of Smith and Wesson's motion to quash service was that of its president. Despite the document's conclusionary averments, the facts that it recites disclose that Smith and Wesson had sufficient contacts with this state to render it amenable to such service of process.

"This affidavit recites that Smith and Wesson, Inc. is a Massachusetts Corporation with offices in Springfield and is not qualified to do business in this state; that it 'has no agents, salesmen, or other employees residing in California, nor any resident representative authorized to adjust any claims or complaints against (it) in California'; that it has no offices nor any property or assets in this state; that it 'does not solicit retail business, but distributes its products F. O. B. Springfield through regular wholesale and dealer channels. Sales promotions are principally conducted by long established firms known as manufacturer's representatives which on their own time and expense solicit business in several allied lines against an overriding discount, or commission, on business initiated by them'; that the 'Walter Lookabaugh Co. of California and its predecessor, the Paul S. Linforth Co. have been known

to us as general manufacturer's representatives specializing in the sporting goods field'; that there is no contract with Lookabaugh Company except that they were 'to promote on a non-exclusive basis the sale of our products on the West coast against a straight commission of 5%'; that Smith and Wesson, Inc., has no financial interest in the Lookabaugh Company nor any control over this company or its employees; that Lookabaugh Company buys its own samples and 'no help or assistance is given them by Smith and Wesson, Inc., except such advertising material as is furnished by Smith and Wesson, Inc. to the general jobbing trade throughout the world'.

"This affidavit discloses that Smith and Wesson's products are distributed in California, that Lookabaugh Company, a manufacturer's representative, promoted its business here though not on an exclusive basis, and distributed general advertising matter furnished by Smith and Wesson. It therefore appears that the material factual averments of defendant's affidavit do not contradict but rather coincide with plaintiff's extended showing of Smith and Wesson's activities in this state through its agreement with Lookabaugh for servicing dealer accounts, investigating and recommending prospective dealers to Smith and Wesson, arranging publicity, distributing

advertising, and handling and reporting on complaints concerning defects in Smith and Wesson's products. In short, this is not a true case of conflicting evidence in which a reviewing court will refuse to disturb findings based thereon. . . .

"From the record it indisputably appears that Smith and Wesson had a continuing arrangement for the distribution and sale of its products throughout this state. Said defendant had retained a manufacturer's representative, Lookabaugh, for the promotion of sales, for the servicing of dealer accounts, and for the distribution of advertising material which defendant furnished in furtherance of its selling activity. Such a regular course of business dealings in sales promotion within the state is similar to the regular purchasing activities of the foreign corporation in the Jahn case and the regular selling activities of the foreign corporation in the Borgward case. Though self-employed as a manufacturer's representative, Lookabaugh was performing much the same type of substantial selling services for Smith and Wesson through a course of regularly-established and systematic business activity as were deemed in Gray v. Montgomery Ward, Inc., 155 Cal.App.2d 55 (317 P.2d 114), to constitute 'doing business' in the state by the foreign corporation there involved.

These services may reasonably be said to have given Smith and Wesson 'in a practical sense, and to a substantial degree, the benefits and advantages it would have enjoyed by operating through its own office or paid sales force.' (Sales Affiliates, Inc. v. Superior Court, 96 Cal. App. 2d 134, 136 (214 P. 2d 541). Certainly, the admitted activities of Smith and Wesson in this state are more significant than the minimal contacts deemed sufficient in McGee v. International Life Ins. Co., 355 U.S. 220 S.Ct. 199, 2 L. Ed. 2d 223), where the foreign corporation elected to deal with its insured, a California resident, only by mail.

"It further appears that the gun which exploded was sold in this state, the accident occurred in this state, the plaintiff is a resident of this state, and many of the witnesses who will probably be called at the trial are present in this state. Therefore, in view of all of the facts, we deem it not inconsistent with 'traditional notions of fair play and substantial justice' to subject the defendant Smith and Wesson to the jurisdiction of the courts of this state in this action.

"The second consideration in testing the validity of service under section 6500 of the Corporations Code is whether the person served is within the statutory designation -- here 'the general manager

in this state' for Smith and Wesson. In this regard, it has been said that 'every object of the service is obtained when the agent served is of sufficient character and rank to make it reasonably certain that the defendant will be apprised of the service made,' and by service on such an agent, 'the requirement of the statute is answered.' (Eclipse Fuel Eng. Co. v. Superior Court, supra, 148 Cal. App. 2d 736, 746.) Whether in any given case, the person served may properly be regarded as within the concept of the statute depends on the particular facts involved. (Ibid; Milbank v. Standard Motor Const. Co., 132 Cal.App. 67, 71 (aa P. 2d 271); Roehl v. Texas Co., 107 Cal. App. 691, 704 (291 P. 255).) Here, it reasonably appears that Lookabaugh as a manufacturer's representative actively engaged in promoting the sales of Smith and Wesson and earning commissions through such sales, would have ample regular contact with Smith and Wesson and would be of 'sufficient character and rank to make it reasonably certain' that Smith and Wesson would be apprised of the service of process. Neither the fact that Lookabaugh's organization was designated as 'manufacturer's representatives' nor the fact that such representatives promoted sales 'on their own time and expense' is determinative here. Whether Smith and Wesson was operating 'through an

independent contract, agent, employee or in any other manner.' (Gray v. Montgomery Ward, Inc., supra, 155 Cal. App.2d 55, 58; Fielding v. Superior Court, 111 Cal. App.2d 490, 494 (244 P. 2d 968); see also Eclipse Fuel Eng. Co. v. Superior Court, supra, 148 Cal. App.2d 736, 740), the essential factor is that Lookabaugh in his selling and advertising activities was performing services for Smith and Wesson and providing it with the opportunit y for 'regular contact with its customers and a channel for a continuous flow of business into the state.' (Sales Affiliates, Inc. v. Superior Court, supra, 96 Cal. App. 2d 134, 136) In short, the arrangement of Smith and Wesson with Lookabaugh appears, in the light of the president's affidavit, to have given Smith and Wesson substantially the business advantages that it would have enjoyed 'if it conducted its business through its own offices or paid agents in the state' (Eclipse Fuel Eng. Co. v. Superior Court, supra, 148 Cal. App. 2d 736, 740); and such arrangement was sufficient to constitute Lookabaugh 'the general manager in this state' for purposes of service of process on Smith and Wesson. (Corp. Code, Section 6500.)" (Emphasis added.)

In the instant case, AMERICAN admits that SHORE-ROBERTSON seels substantial quantities of its products in California.

Furthermore, the infringing sale occurred in this state, plaintiff is a California corporation and many witnesses who will probably be called at trial are present in California. As a matter of California law, on the facts already known, the District Court had jurisdiction over the person of AMERICAN. But even if this Court disagrees, surely the District Court abused its discretion by deciding the question without first permitting discovery and a hearing. Cf. Ziegler v. Standard Oil, 32 F. R. D. 241, 135 USPQ 350, 251 (N. D. Calif. 1962).

One other point: AMERICAN can apparently still raise jurisdiction over its person by answer. Phillips v. Baker, 121 F.2d 752, 50 USPQ 540, 541-542 (9th Cir. 1941). However, plaintiff urges the Court to overrule Phillips v. Baker, supra, in view of the criticism levelled at it by most of the Courts and writers who have considered it. Elbinger v. Precision Metal Workers, 18 F. R. D. 467, 469 (E. D. Wis. 1956); Keefe v. Derounian, 6 F. R.D. 11, 13 (N. D. Ill, 1946); Crum v. Graham, 32 F. R. D. 173, 175 (D. Mont. 1963); 1 A Federal Practice and Procedure by Barron and Holtzoff, Section 370, pp. 524-525; 1 Moore's Federal Practice, Para. 12.23 pp. 2327-2328, note 2.

II

AMERICAN HAD NO STANDING TO CHALLENGE VENUE AFTER DEFAULTING.

In Orange Theatre Corp. v. Rayherstz Amusement Corp., 130 F. 2d 185, 6 FR Serv. 66.12, Case 1 (3rd Cir. 1942), the

defendants moved to dismiss for lack of venue after defaulting. The District Court granted the motion. The Court of Appeals reversed, saying:

> "We have then this situation: the stipulations extending the time were ineffective and the defendants are in the position of having failed to plead or otherwise to defend within the twenty days allotted under Rule 12(a). They are, therefore, in default. There has been no entry of default in accordance with Rule 55(a). But that entry is a purely formal matter. When this case is remanded the defendants may apply to the trial judge to be permitted to answer under Sections 55(c) and 60(b) of the Rules."

The importance of the outlined procedure is this: Rule 55(c) requires a showing of "good cause" for relief from default. So far, AMERICAN has given no explanation other than apparently being busily engaged in the preparation of the Delaware declaratory judgment action.

Respectfully submitted,

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Attorneys for Appellant
The Bobrick Corporation

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Thomas P. Mahoney
THOMAS P. MAHONEY

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[illegible]

[illegible]

[illegible]

[illegible]

NO. 20,099

United States Court of Appeals
for the Ninth Circuit

JACQUES ARLEY and CHARLOTTE ARLEY, husband and wife,

Appellants,

v.

UNITED PACIFIC INSURANCE COMPANY, a Washington corporation,

Appellee.

Appeal from the United States District Court for the District of Oregon

APPELLANTS' REPLY BRIEF

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OTHER AUTHORITIES

* * *

'lease note:

Arff v. Star Fire Ins. Co., 125 N.Y. 57, 21 Am. St. Rep. 721 (1890). was inadvertently ommitted from page 53 of Appellants' Brief.

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APPELLEE NOW URGES NEW THEORY

The insurance company brought this suit against the Arleys for fraud. No other reading of the complaint is possible ("VII" R. 17).

But at the trial and on the basis of Chaney's conduct subsequent to *January* 16, 1963, the company sought to discredit only Chaney on the theory that Chaney was then "acting" as broker for the Arleys.

On appeal the company has abandoned its reliance on Chaney's (alleged) fraud and its contention that Chaney was acting for the Arleys on January 16, 1963.

Appellee has a new theory. Appellee now says that the policy was void ab initio and therefore the company's liability must be determined by whether Chaney was in fact "acting" as broker for the Arleys "during the discussion with Mrs. Arley" on *October* 30 *or* 31, 1962. The *"alleged contract"* is void, appellee says, because Chaney failed to order it until the loss occurred. (Appellee's Br, 4, 10, 11).

Appellee's new theory undoubtedly results from the view the court seemed to take of this case. In addressing the jury at the beginning of trial, the court said:

> "United Pacific Insurance Company has brought this action to secure a declaration of rights and liabilities under a certain *alleged* insurance policy which was issued as of the date of January 12th, 1963. But the actual time of the issuance of the policy is in dispute. Although it may be dated that date there is a dispute as to the validity of the policy. (Emphasis ours).
>
> * * *
>
> *** So the issue that is to be tried out her today is whether there is any liability on th policy, and that is what the jury selected will de cide." (Tr. 6, 6a).

Appellee seems to be contending that unless Chane ordered the policy prior to the loss, the policy has n value. And if Chaney in fact did not order the polic until after the loss, then the rights of the parties hav to be determined by the preliminary oral contract.

The trouble with this contention is that the poli

ears a countersignature date of "1-12-63." It is countrsigned by a duly authorized agent of the company nd by its terms it was in effect ("From: January 12, 963 To: January 12, 1966") at the time of the fire. 'he policy is valid on its face. It is without ambiguity. bsent fraud or mutual mistake it is entitled to the ame dignity accorded every other written contract.

> *Northern Assurance Co. v. Grand View Building Assoc.,* 183. U.S. 308, 331, 22 S. Ct. 133, 46 L. ed. 213[1]

But even if the policy had not been countersigned ntil January 17, 1963, the date Chaney said he ordred it — or February 15, 1963, the date Linda Upton aid it was typed — the policy would be valid. The tipulation which goes to the validity of this policy imply states that * * "this policy shall not be valid *nless* countersigned * *." Such a stipulation has only o do with the authenticity of the policy. It has nothing o do with the time from which the policy becomes efective. (Emphasis added)

> "Countersigning merely confirms the period of liabilty set forth in the policy and gives retroactive force to the date when by its terms it becomes effective." *Oklahoma Farm Bureau Mut. Ins. Co. v. Brown,* 255 P2d 919 (Okla. 1952)

> "The date from which a policy becomes effective is not necessarily determined by the date which it bears or the date of its execution or the date of its delivery * * *. It is the date from which the risk is commenced, and it is determined by the meaning of the provisions of the in-

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[1] Footnotes referred to may be found in Appendix pp. i through vi.

surance contract." *Schwartz v. Northern Life Insurance Co.,* 25 F2d 555 (9th Cir. 1928).

Dillon v. General Exchange Ins. Corp., 60 S.W. 2d 331, (Tex. 1933), *National Union Fire Ins. Co. v. California Cotton Credit Corp.* 1935, C.A. 9th 76 F2d 279, cited in ANNO: Insurance Policy — Counter-signature, 22 ALR 2d 984.

Appellee by the position it now urges necessarily admits the record is devoid of fraud and that the insurance company has failed to make its case. This does not now give appellee the right to ignore the policy.

The policy is valid. In replying further appellants intend no departure from this position.

Roger Chaney Was Appellee's Agent As A Matter Of Law

Assuming argunedo the insurer were not estopped to raise the issue of Chaney's agency, the statutory law of Oregon forbids it.

The insurer is estopped because (1) it stated as its ground for denying liability that the Arleys did not request coverage until after they knew fire had destroyed their property. It may not now rely on another ground *Ward v. Queen City Ins. Co.* 68 Or. 347, 138 Pac 1067, 1068,

The insurer is estopped because (2) the policy it issued was produced through the office of its authorized agent, Larry Nelson. *Schoener v. Hekla Fire Ins. Co.* 7 N.W. 544 (Neb.), *Shook v. Retail Hard. Mut. Fire Ins. Co.,* 134 S. W. 589, (Mo.).

But the statutes are controlling. The Supreme Court on certiorari from the Ninth Circuit in Stipcich v. *Metropolitan Life Ins. Co.* 277 U.S. 311, 48 S. Ct. 512, 72 L. ed. 895 (1927) held that the question of agency "must be resolved in the light of the Oregon Statutes" and that the obvious purpose of the statutes was "to require the company to provide some agency within the state with which the insured may safety deal in matters relating to his application." *Northwestern Mut. Life Ins. Co. v. Cohn Bros.*, 102 F2d 74 (9th Cir. 1939).[2]

Chaney's Acts Were Ex Parte

Appellee places its case almost entirely on the ex parte acts of Chaney in attempting to broker coverage. These acts were not only *prior to the time Chaney told Mrs. Arley she was covered,** but IT IS ILLEGAL IN THE STATE OF OREGON FOR AGENTS TO SPLIT COMMISSIONS.

ORS 736.620 requires that every policy shall bear on its face the premium to be paid. It then provides in part that no insurance agent shall pay any part of his commission, subject to penalty and loss of license. A comprehensive analysis of "brokerage" under laws similar to Oregon's is found in *O'Neal v. Schneider* 145 F. Supp. 120, 126 (Ark. 1956).[3]

See: 11 *Op. Atty-Gen.* 361, 1922-24 construing *O.L.* 6362, now *ORS* 736.620 as not precluding *non-resident brokers* from sharing commissions with other agents.

Appellee has misstated the evidence on which appellee so strongly relies to convert Chaney into a broker for the Arleys.

> "Of course the company could not make their agent also the agent of the insured, unless the insured chose to recognize him as his agent * * to attempt to dignify a situation of this sort into a real agency for the insured is wholly unjustifiable, both in law and fact, and is rather calculated to change the honorable charter of the cause *into a snare for the unsuspecting.*" *Beebe v. Hartford M. F. Ins. Co.,* 25 Conn. 51, 65 Am. Dec. 553. (Emphasis added).

*Appellee says (Br. 6, 7): "*After the conversations with the Arleys in the fall of* 1962, *Chaney atttempted to broker the insurance coverage through other sources*" Reference to the transcript in the same order set out by appellee indicates, however, that the time was *not* in the fall of 1962, but in each instance the times are respectively stated to be: "early summer of '62" (Tr. 13); "summer of 1962" (Tr. 69-71); "July or August of '62" (Tr. 124,125). Appellee also says that "Chaney advised Mrs. Arley that he did not have a Nevada license but that they would attempt to broker the insurance for her." (Tr. 105). Reference to the transcript shows that what was read into the record was a portion of a recorded statement taken from Chaney by the company on March 21, 1963. Chaney said that:

> "in the latter part of 1961 or the early months of 1962," he told Mrs. Arley that he "would wri

it * * as we had before. I then found that we did not have a Nevada non-resident's license, which I informed her of *but assured her that I would get it taken care of*." (Emphasis added)

Q. Now, after you learned that you no longer had a nonresident Nevada license, what became of your intent to write the coverage then?

A. I informed her of the fact that we did not and I said I would have to see what else I could do because it would probably have to be brokered or we would have to take out another license. I had learned of a different commission structure, and this was the reason that I didn't immediately order the nonresident license or have Mr. Nelson do so.*"

Assuming this evidence to be competent and taking to be true (in 1961 and early 1962 Nelson had a onresident license (Tr. 11), all of it having occurred *rior to October* 30 *or* 31, 1962, the time when Chan-y told Mrs. Arley she was covered (Tr. 90), and *rior to December,* 1962, when Chaney again told Irs. Arley she was covered (Tr. 92, 93), it is as noth-ig.

Appellee also says that Larry Nelson "specifically structed Chaney that he could not write the coverage r the Arleys" (Tr. 13, 70). There is nothing in the cord to show that Nelson advised the Arleys that haney could not bind the company.

* *

"I shall assume that the agent departed from his instructions. * * * This hypothesis will not aid the defendants. Haymer was a general agent * * and acted within the general scope of

> authority in taking this risk. Although he must answer to his principals for departing from their private instructions, *he clearly bound them so far as third persons, dealing with him in good faith, are concerned.* * * This rule is necessary to prevent fraud, and encourage confidence in dealings * * the plaintiff had a right to believe that the defendants reposed unlimited confidence in Haymer in relation to the subject of his agency, and *it would be a monstrous doctrine to hold that they may now discharge themseves by setting up their private instructions, which were wholly unknown to the plaintiff when he entered into the contract." Lightbody v. No. American Ins. Co.*, 23 Wend. 18 (1840) (emphasis added).
>
> *Universal Ins. Co v. Kruse*, 306 F2d 661, 66[illegible] (9th Cir. 1962).

There is nothing in the record to indicate that Chane at any time in all of this period ever held himself ou to be anything but what he was: An Insurance Agen

Case Law Does Not Support Appellee's Statement

Appellee states that "It is well established in th State of Oregon that a general insurance agent may a as an agent or broker on behalf of an insured." (Br. 7 To support this statement appellee cites and quot from *Hamacher v. Tumy*, 222 Or. 341, 352 P2d 49 (1960) and *Rodgers Insurance Agency v. Anders Machinery*, 211 Or. 459, 316 P2d 497 (1957). each case the quoted material merely states a gene proposition of insurance law—not Oregon law. Te quotation from *Rodgers* reads:

> "*The law appears to be well settled that* an insurance agent or broker who for a consideration agrees to procure insurance for another will be liable for any damage resulting from an unjustifiable breach of the agreement." (emphasis denotes omission by appellee)

Neither case was a suit against an insurer on a con-
ract of insurance. Each was a suit against an agent for
is *negligent failure to procure insurance* and this dis-
inction was made (*Hamacher, page* 349.) The court
vas not called upon in either case to decide whether
n Oregon an agent may act for the insured. What the
ourt had to decide in the *Rodgers* case the court stated
n the course of the opinion in *Hamacher* (p. 348):

> "The Rodgers case simply holds that the insurance agent is not liable for failure to procure issurance unless the parties agree upon the type of insurance which is to be procured. The case may also be regarded as standing for the elementary legal proposition that a contract will not arise until there is sufficient certainty in the proof of its terms."

In *Hamacher* what the court had to decide was "the
haracter of the evidence which must be adduced by
he plaintiff in order to establish the contract out of
vhich the defendant's duty arises."

Neither case is pertinent.

Prior even to the Code case law in Oregon held that
he local agent of an insurance company who solicits
usiness for his principal and *prepares an application*
r a policy, is the agent of the company, and his mis-

takes are its mistakes. *Brugger v. State Inv. Ins. Co.,* Case No. 2,051; *Hardwick v. State Insurance Co.,* 20 Or. 547, 26 Pac. 840; *McElroy v. British American Assurance Co.,* 94 Fed. 990 (9th Cir. 1899). See also *Jackson v. New York Life Ins. Co.,* (D.C. Or.) 299 Fed. at 679.

Appellee comments that because Chaney did not hold a nonresident license he was not acting for the company. Chaney was licensed under the Insurance Law of Oregon and under Oregon law he could act only for the company.

The Policy Is Valid

> "There is no suggestion that the preliminary contract in this case was not made in perfect good faith on both sides * * *." The credit allowed for the payment of the premium was an indulgence which the agents were authorized by general usage to give. Its allowance did not impair the preliminary contract; that, being valid, could have been enforced in a court of equity against the company; and having been enforced by the procurement of a policy, an action could have been maintained upon the instrument, or the court in enforcing the execution of the contract might have entered a decree for the amount of the insurance. But no resort to a court of equity for specific performance was necessary in this case by reason of the agents in filling up the blank policy, which was duly attested, as they should have done immediately after the preliminary arrangement with the assured. *The agents were authorized to do after the fire that which they had previously stipulated to do on behalf of the company.* The original neglect to fill up the blank

> policy at once constituted no valid reason for further delay. If the policy filled up at once would have bound the company, so must the policy subsequently filled up. The relations of the parties and the obligations of the company were not changed by the neglect of the agents. The filling up of the policy was a voluntary specific performance of the preliminary agreement. (Emphasis added)

This language from *Insurance Company v. Colt,* 87 U.S. 560, 20 Wall. 560, 22 L.ed. 423 (1874) could not be more appropriate. For all practical purposes it is this case. In *Colt,* however, the policy was "filled up" *upon the request of the insured.* The company knew nothing of the matter until after the loss. After consultation with their agent the insurer refused delivery of the policy.

The agent could have "filled up" the policy in this case except, the property being in Nevada, it was necessary that a Nevada agent countersign it. This made it necessary to have the policy processed through the branch office of United Pacific which happened to have an office in Portland. It is out of this fact difference that this insuer seeks still some other means to escape liabilty. But until the company knew of the loss it was glad to have Chaney write the business. The fact is the company was so glad it tried to get a Nevada license quickly enough so their local agents could share in the commission. (Pl's. Ex. 8, Tr. 156, 157). And until the company knew the full extent of the loss it treated the policy as good.

> "There can be no doubt that the defendants would have considered the policy good if the fire had not occurred on the 14th of March, 1860, and that by its terms it would have related back so as to cover the risk from the 9th of February. We can perceive no justice in allowing the company to say that the policy would have been binding and valid from the ninth day of February, if no fire had occurred, but that it is void and of no effect because a fire took place on the 14th of March thereafter. When the defendants accepted the premium and delivered the policy, the agreement to insure was complete and executed, and related back to the 9th of February 1860, and *the insured was under no legal or moral obligation to notify the company that the building had been burned.* * * (emphasis added) *Keim v. Home Mut. Fire Ins. Co.,* 42 Mo. 38, 97 Am. Dec. 291, 293.

The Risk Had Been Bound.

Appellee argues this case (Br. 10, 11) as though Roger Chaney had not bound the risk. When Chaney told Mrs. Arley she was covered—and even on redirect examination Chaney insisted: *"I had told Mrs. Arley that she was covered."* (Tr. 100), coverage was bound. That no policy was ordered until after the loss is immaterial.

It is no defense that a policy is issued subsequent to a loss if by its terms the risk is to commence from a time past. When the terms are clearly expressed courts may not alter them. *Hallock v. Ins. Co.,* 26 NJ Law 268, 284.

> "Where a risk is to commence previous to the date of the policy, and the property is destroyed before the policy is actually executed and delivered, if there is no fraud or concealment by the party insured, the company will be as much bound as if the loss occurred after delivery of the policy." *Ins. Co. v. Hallock*, 27 NJL 647 (1858)

None of the cases cited by appellee is pertinent. None touches this case. Most go to the proposition that a broker who represents more than one company, and who, without authority from the insured and without the knowledge of the insured cancels a policy in one company and writes a substitute policy in another *company*, fails to make a valid contract if the second policy is not accepted by the insured prior to the loss.

In support of the same proposition appellee quotes from Section 9163, 16 *Appleman Insurance Law Practice*, p. 703. The entire section reads:

> "An agent of an insurance company generally has no authority to bind his principal by attempting to insure property already destroyed. The filling in and delivery of a policy on property known to be already destroyed cannot be treated as a ratification of a prior imperfect contract to insure, ratification by an agent after knowledge of a fire being unauthorized. *But where an agent is authorized, after a preliminary contract for insurance is made by him, to fill up a blank policy duly signed and attested by the officers of the company, sent to him for the purpose, he is authorized to fill up such policy after a loss has occurred."* (emphasis added to indicate omission by appellee)

See distinction made in *Stebbins v. Lancashire Ins. Co.,* 60 N.H. 65. 70:

> "It was not an acceptance of a proposition for a contract of insurance, *like the case of a policy issued on a previous application,* which, as in the cases cited by the plaintiff take effect upon the acceptance of the application." (emphasis added)

Also *Gambleman v. Mercantile Ins. Co. of America,* 187 F.2d 654, 657 (9th Cir. 1950).

Liability Of Insurer Is Not Affected Because Insured Does Not Know Name Of Insurance Company.

Appellee states it is "requisite to proof of an oral contract of insurance" that the insurer be named. (Br. 18, 19). Appellee is wrong. Appellee's inference that Oregon requires this proof is baseless and objectionable. No authority cited by appellee supports the statement appellee makes.

Cases contra are legion.[4]

In *Port Investment Co. v. Oregon Mutual Fire Ins. Co.,* 163 Or. 1, 94 P2d 734 (1939), the Supreme Court of Oregon said:

> "a fire insurance agent ordinarily does not represent merely one company, but several, and solicits business, not on behalf of a particular company, but on behalf of his agency, and, when he has obtained the business, uses his own judgment in placing the insurance with one or more of the companies which he represents. This not only ap-

> pears in the record in this case, but is a fact which may be judicially noticed."

In the instant case United Pacific was the *only* insurer who could write the business in Nevada; it was the *only* insurer through whom Nelson ever had a nonresident's license, and it was the *only* insurer to whom this risk could be "allocated." This, the record makes abundantly clear.

Instructions

The distinction which appellee fails to see in appellants' alternative instruction No. 3 and the language used by the court is in the difference in *dates.* (Appellants' Br. 19; Tr. 261).

The effect of the court's instruction was to prohibit the jury from finding for the appellants unless the jury found,

> "that Chaney *on or about October* 30*th or* 31*st,* 1962 * * *named the United Pacific Insurance Company as the fire insurance company that would issue the policy* * *."

On this ground alone appellant would be entitled to a new trial.

There Is In This Case No Mistake

The "mistake" of which the insurer complains is that it *believed* the property "was in existence and in good condition at the time the policy was issued"

(Br. 16, 17). Appellants notified the only agent they knew of the loss and were advised by him NO OTHER NOTICE WAS NECESSARY. (Tr. 227, 228)

When Roger Chaney ordered the policy issued, he dated his memorandum 1-17-63. (Pl.'s Ex. 8). It asked that a *fire* policy be issued effective 1-12-63. ROGER CHANEY did not prepare the policy. "The policy having been prepared by the the insurance company, its terms must be construed against it and it must be held bound by them." *Hill v. Industrial Accident Commission,* 51 P2d 1126 (Cal. 1953).

> "Had they undertaken to insure from and after the making of the policy no action could have been maintained for a prior loss but the company having unequivocally taken the risk of a fire having occurred subsequent to the time specified, and having received the premium for so doing, *cannot allege that they have acted under a mistake." Insurance Co. v. Hallock,* 27 NJL 647, 655. (Emphasis added).

In *Bankers Lloyds v. Montgomery,* 42 S.W. 2d 285, (Tex. 1931), in a similar fact situation dealing with compensation insurance, the insurer sought to defend on the ground that the policy having been issued subsequent to the loss, it could now prove the agent lacked authority to bind the company. The court held the insurer was charged with knowledge that an injury may have occurred and that any such defense was foreclosed.[5]

In *Violin v. Fireman's Fund Insurance Company* (—Nev.—) 406 P.2d 287, 290 (1965), the insured falsely represented that no company had cancelled him. In fact Fireman's had itself done so four years previously and its files so showed. The insurer sued to rescind the policy and prevailed below. In reversing the decision of the trial court, the Supreme Court of Nevada held that the insurer was chargeable with actual notice as *a matter of law* and the company had waived its power to rescind the contract. The court said:

> "Specifically we hold that the insurer waived its power to rescind the insurance contract by issuing the policy with knowledge that the insureds had fraudulently misrepresented a material fact in their application for insurance."

See also: *Day v. Hawkeye Ins. Co.,* 72 Iowa 597, 34 N.W. 435, 437 (1887).

Equity Jurisdiction Was Wanting

Appellants' position that the trial court could not enlarge its jurisdiction by trying appellee's suit in equity as a declaratory judgment action has been stated. (Opening Br. 28). *Commercial Casualty Ins. Co. v. Fowles,* 154 F2d 884 (9th Cir. 1946) citing *Aetna Casualty & Surety Co. v. Quarles,* 92 F2d 321 (4th Cir. 1937). *Ettleson v. Metropolitan Life Ins. Co.* 137 F2d 62, 65 (1943)

The cases cited by appellee are not pertinent (Br. 16). None raised the question of the court's *equity* jurisdiction.

> "Whether a suitor is entitled to equitable relief in the federal courts, is strictly not a question of jurisdiction in the sense of the power of a federal court to act. It is a question only of the merits, whether the case is one for the peculiar type of relief which a court of equity is competent to give. *DiGiovanni v. Camden Fire Ins. Assn.,* 296 U.S. 65, 68, 56 S.Ct. 1, 3, 80 L. Ed.47.

Appellants' Rights Have Been Prejudiced

This suit was brought against the appellants for fraud. Appellants' demand for jury was based on the *issue of fraud* which was the *only* issue the insurer was entitled to try in this case. Appellants' demand for jury was in their action on the policy.

In retaining jurisdiction of this case and in trying the action as one for declaratory judgment the court gave to this insurer every advantage. The insurer tried out every issue it could have hoped to raise in defense of appellants' action at law, at a time and place of its choice.

Moreover, it need not be said that a party has a right, prior to the moment of trial, to know what the trial will be. It is one kind of trial to defend against fraud. It is another *for the insured to defend*

a preliminary contract against the *failure of parties*. And under the instructions of the court, the jury could have thought this. Or the jury could have found against appellants because they thought Chaney had in fact been a faithless agent on January 16, 1963, even though the insurer now contends January 16, 1963, is not an issue in this case. Or the jury might have found against the appellants because they thought the policy was misdated. Or that if the policy was "ordered" after the fire that made it bad. See: *Rommel v. New Brunswick Fire Ins. Co*, 8 N.W.2d 28 (Minn. 1943)

"This case is an illustration of the confusion and uncertainty which (was) occasioned by permitting the introduction of parol evidence to modify (the) written contract(s) * *. *Northern Assurance Co. v. Grand View Building Assoc.*, supra, 183 U.S. 308, 364.

The error in the court's failure to make findings also brings this case squarely within the views expressed by Pope, Circuit Judge in *United Press Associations v. Charles*, 245 F2d 21, (9th Cir. 1957).

CONCLUSION

The trial court was without jurisdiction to try appellee's suit in equity. In hearing the case as one for declaratory judgment the court exceeded its jurisdiction and in effect has deprived these appellants of their day in court.

The matter having been tried, appellants respectfully submit that on the merits the judgment of the trial court must be reversed.

Respectfully submitted,

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APPENDIX

[1]"To except policies of insurance out of the class of contracts to which they belong, and deny them the protection of the rule of law that a contract which is put in writing shall not be altered or varied by parol evidence of the contract the parties intended to make, as distinguished from what appears, by the written contract, to be that which they have in fact made, is a violation of principle that will open the door to the grossest frauds * * *. A court of law can do nothing but enforce the contract as the parties have made it. The legal rule that in courts of law the written contract shall be regarded as the sole repository of the intention of the parties, and that its terms cannot be changed by parol testimony, is of the utmost importance in the trial of jury cases, can never be departed from without the risk of disastrous consequences to the right of parties."

[2]"The meaning of the statute is clear, and one does not have to go far to ascertain the legislative intent that prompted its enactment. Obviously, one of its main purposes was to put a stop to the irritating and unjust practice indulged in by some insurers of adroitly phrasing their agency contracts in a way to bestow general powers on their agents, who come in direct contact with the public, when such powers relate to benefits flowing to the company, and to invest such agent with no power to represent the company when the benefits of the insured are involved. Such attempted aggressions frequently have been repelled by the courts of this state under the doctrine that 'an insurance company cannot make its local agent the medium through which all the benefits of a policy flow from the insured to it, and then deny that he has authority to represent it when the benefits of the insured are involved * *." *Sheets v. Iowa State Ins. Co* 1911 (Kan.) 135 S.W. 80, 84.

> "The suggestion is made on the brief of the learned counsel for the defendant that Lawson should be treated as the agent of the plaintiffs, and not the agent of the company, but this view leads to the manifest absurdity that the plaintiffs made the contract of insurance with their own agent, which is not to be entertained.
>
> * * *
>
> "The obvious intention of the legislature is to make an insurance company responsible for the acts of the person who assumes really to represent and act for it in these particulars, and to change the rule of law that the insured must at his peril know whether the person with whom he is dealing has the power he assumes to exercise, or is acting within the scope of his authority. *Schoener v. Hekla Ins. Co.*, supra (Neb.) 7 N.W. 544.

In Ins. Co. v. Chamberlain, 132 U.S. 304, 307, 10 S. Ct. 87, 33 L. ed. 341 (1889) the Supreme Court said:

> "By force of the statute he was the agent of the company. *He could not by any act of his shake off the character of agent for the company* nor could the company by any provision in the application or policy convert him into an agent of the assured. If it could, then the object of the statute would be defeated." (Emphasis added).

MacDonald v. Milwaukee Mech. Ins. Co., 167 F2d 276, 278 (7th Cir. 1948), certiorari denied:

> "The District Court would have been justified in submitting the question of Anderson's agency to the jury only if there was reason to believe that the insured had notice that defendant had revoked Anderson's authority or had limited it."

[3]"There is no law providing for the creation licensing or regulation of an insurance broker, nor is there any law for payment of a so-called brokerage by an agent in this state to another agent operating in this state. However, many other states have now and for several years have had provisions of law for licensing and regulating insurance brokers, for example California and New York, as well as one or more states adjoining this one. Operations under these laws eventually brought about the enactment of a statute of this state providing for the licensing of non-resident insurance brokers and for the division of commissions with agents in this state on a reciprocal basis * *. Then, too, the word 'broker' has occassionally slipped into Arkansas Statutes introduced as uniform laws, copied from the laws of other states which have legally qualified and acting brokers— * * *. As used in these Acts, the term 'broker' is, of course meaningless. It is doubtless that the appearance of the term in those statutes has confused or misled anyone."

* * *

"I must point out that there is nothing in the record * * to establish that the Insurance Commission * * has interpreted the law to mean that any insurance agent of one company is duly authorized to broker insurance through the agent of another company and receive the commissions thereon. Such an interpretation would make a mockery of the whole framework of the law governing insurance companies and their agents."

The court under the circumstances of that case held the transactions to be "flagrantly illegal."

[4]In *Sholund v. Detroit Fire & Marine,* 172 Wn. 111, 19 P2d 395 (1933), which appellee cites (Br. 11, 18), one of the headnotes reads:

> "Agent may bind fire insurer to risk by oral contract to insure without disclosing company to insured."

See: *United States Fidelity & Guaranty Co. v. Goldberger,* 13 F2d 779 (Cir. 3, 1926)

> holding Insurer's liabilty for loss occurring before execution of policy is unaffected by insured not knowing with which company he was dealing when agreeing with the agent for insurance."

Aetna Ins. Co. of Hartford, Conn. v. Licking Valley Milling Co., 19 F2d 177, 180 (Cir. 6, 1927),

> the court held the insurer was liable on the doctrine of undisclosed principal (no knowledge by insured of company until after loss).

Fireman's Fund Ins. Co. v. Leftwich, 90 SW2d 497 (Ark. 1936)

> "Since these policies were actually issued by the duly authorized agent of appellants, the argument that (the agents) represented other insurance companies is beside the question. An actual designation was made of appellants by those in authority and we prefer to deal with reality instead of conjecture."

Guipre v. Kurt Hitke & *Co.,* 240 P2d 312, 317 (Cal. 1952)

> "There is evidence here which shows that Kurt Hitke Co. * was general agent for only one automobile insurance company writing" (that type of insurance).

Durbin Paper Stock Co. v. Watson-David Ins. Co., 167 So. 2d 34, 36 (Fla. 1964)

> "This is not a question of an undisclosed principal. Here the plaintiffs did not know the exact identity of the principal, but they knew that a principal existed, in that they did not intend for the agent to insure their building. They intended for the agent to act as an agent, not a principal, and obtain insurance for them from a third party."

[5]"Whether Cox had any authority or not to bind the company to an agreement that the insurance should be in force from the time he took the informal application, the subsequent issuance of the policy, in effect, expressly so providing, eliminated any question of that agent's authority, or the materiality thereof."

* * *

"The insurer, in directing Cox as its agent to deliver the policy, which expressly covered a liability for any time subsequent to one minute after 12 o'clock a.m., August 31, 1929, was charged wth knowledge that an injury may have occurred and a consequent liability already accrued. It had the means of protecting itself against that possibility by directing an investiga-

tion to ascertain if such was the fact, and if found to be so, in declining to deliver the policy. Had that course been pursued, then the authority of Cox would have become a very material inquiry. But, as we have already said, as we view it, that question has been rendered immaterial.

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

CHARLOTTE HUNTER ARLEY
Attorney for Appellants

No. 20099

COURT OF APPEALS
United States
for the Ninth Circuit

JACQUES ARLEY and CHARLOTTE ARLEY,
husband and wife,

Appellants,

v.

UNITED PACIFIC INSURANCE COMPANY,
a Washington corporation,

Appellee.

Appeal from the United States District Court
For the District of Oregon

BRIEF FOR APPELLEE

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No. 20099

COURT OF APPEALS
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Appeal from the United States District Court For the District of Oregon

BRIEF FOR APPELLEE

APPELLEE'S STATEMENT OF THE CASE

FACTS

Appellants Jacques and Charlotte Arley are husband and wife and were married in 1954 (Tr. 245). They own certain real property near Verdi, Nevada, which was damaged by fire on January 15, 1962 (R. 53, 54).

The appellants have resided in Oregon since some time in 1958, Jacques Arley being employed by the Mon-

tag Furnace Company in Portland (Tr. 179, 180). Jacques Arley maintains a bank account with the First National Bank of Oregon (Tr. 180). Both the parties' cars are registered in the State of Oregon (Tr. 180).

The appellants became acquainted with Roger Chaney some time in 1958 and thereafter obtained some of their insurance policies through him (Tr. 217). At the time Chaney operated an independent insurance agency as agent for Insurance Company of Oregon, Standard Accident and Ohio Casualty (Tr. 59). The appellants obtained a fire policy on the Verdi, Nevada property from Chaney, which was written by Standard Accident Insurance Company, effective January 28, 1958, for a period of three years. This policy was cancelled in November, 1960 (Tr. 183). From 1960 on until the time of the present action there was no insurance on the Verdi property (Tr. 184). Druing this period the appellants had considered having agents in Reno, Nevada take care of this coverage (Tr. 184).

In 1961 Chaney's business was purchased by the Larry Nelson Agency and Chaney became a solicitor for that agency (Tr. 12). The Nelson Agency represented various companies including Insurance Company of Oregon, Western Fire of Fort Worth, United Pacific, Ohio Casualty Company (Tr. 9). The Nelson Agency did not take over the fire policy on the Arleys' Verdi, Nevada property (Tr. 12).

In the summer and fall of 1962, Roger Chaney had various conversations with Mrs. Arley about placing fire coverage on the Verdi, Nevada property (Tr. 66, 73, 89).

Larry Nelson advised Chaney that he could not place the coverage through the Larry Nelson Agency as the agency did not have a Nevada license (Tr. 13, 70, 121). Roger Chaney told Mrs. Arley that he did not have a Nevada license but that they would attempt to broker the insurance for her (Tr. 105). Chaney told Mrs. Arley he would take care of the coverage but does not recall ever advising her of the name of any particular company (Tr. 68, 80, 81, 90). Thereafter Chaney made inquiry as to how he might place the insurance and share in the commission and called other agents and brokers about placing the coverage (Tr. 70, 71, 124).

On the morning of January 16, 1963, Mrs. Arley called Chaney and advised him that there had been a fire loss on the Verdi, Nevada property and inquired as to whether Chaney had put insurance on it (Tr. 73). Later that day, Chaney called Mrs. Arley back and advised her that he had placed fire insurance on the property (Tr. 74). *In fact Chaney had not placed insurance on the property* (Tr. 72, 73, 74, 75).

Subsequent to being advised of the loss on January 17, 1963, Chaney submitted an application for insurance to the United Pacific Insurance Company. The application did not indicate in any manner that the property had been previously damaged by fire (Tr. 76).

Thereafter and some time in March, 1963, appellants received United Pacific Insurance Company Policy No. F-78185 (Exhibit No. 52). That at the time this policy was processed, the United Pacific employees handling the application did not know that the Arley property

had been previously destroyed by fire (Tr. 131, 143, 151, 202). The Company would not have processed the application had it know of the loss (Tr. 202).

Thereafter Roger Chaney on March 5, 1963, without the knowledge of United Pacific Insurance Company, contacted Mr. Marks of General Adjustment Bureau in Reno, Nevada, to inspect the damaged premises (Tr. 167, 177).

On April 2, 1963, United Pacific Insurance Company wrote appellants denying coverage (plaintiff's Exhibit 56).

Appellee denies that the court erred as urged in appellant's specifications of error.

BASIC ISSUES

It is undisputed that the fire insurance policy in question was not delivered to the Arleys until after the property had been lost by fire. *The law is clear that if this policy was not applied for until after the loss, then it is void.* The basic question is: Was the insurance policy ordered prior to the time of the fire? In order to determine this question the jury had to decide: Was Chaney during the discussions with Mrs. Arley on the 30th or 31st of October, 1962, acting for the Arleys or for the United Pacific Insurance Company?

ARGUMENT

I

Roger Chaney Acted as the Agent or Broker for the Arleys During the Course of Dealings in Question.

There is ample evidence to support the verdict of the jury.

The factors to be considered by the jury were amply set forth by the Court's instructions. The Court on this issue instructed (Tr. 258):

> "Now the principal issue to be decided by you in this case under the issues as formulated is whether Chaney, who had been named as solicitor by the Nelson Company, was during Chaney's discussions with Mrs. Arley on the 30th or 31st of October, 1962, acting for the defendants or was he acting for the plaintiff in the course and scope of his authority as a solicitor for Nelson? * * *"

The Court further amplified this by instructing (Tr. 261):

> "If on the other hand you find that Chaney on or about October 30th or 31st, 1962, while acting within the scope of his authority with the Nelson Company, represented to the defendant Mrs. Arley that the buildings owned by the defendants near Verdi, Nevada, were covered by fire insurance and named the United Pacific Insurance Company as the fire insurance company that would issue the policy and that the amount and date of the coverage was definite and that the issuance of the policy here in question was the outgrowth of said repre-

> sentations, if any, then and in that event your verdict should be in favor of the defendants on the issues here presented."

The evidence sustaining the verdict is as follows:

At the time that Chaney first began handling insurance matters for the Arleys he was in no way connected with United Pacific Insurance Company (Tr. 59) and the coverage that he had obtained in the past for the Arleys was through companies other than United Pacific (Tr. 61, 62).

At the time of the dealings in question, Chaney had disposed of his own agency and was employed as a solicitor by the Larry Nelson Agency *and his employer, Larry Nelson, had specifically instructed Chaney that he could not write the coverage for the Arleys* (Tr. 13, 70).

Chaney and the Nelson Agency represented various companies other than United Pacific (Tr. 9).

After the conversations with the Arleys in the fall of 1962, *Chaney attempted to broker the insurance coverage through other* sources (Tr. 13, 70, 71, 124). *Chaney advised Mrs. Arley that he did not have a Nevada license but that they would attempt to broker the insurance for her* (Tr. 105).

Chaney did not recall ever advising Mrs. Arley the name of any particular company (Tr. 68, 80, 81, 90). This was disputed by Mrs. Arley but it was a question of fact properly determined by the jury.

The fact that Roger Chaney was not acting on be-

half of United Pacific but in fact was attempting to broker the coverage through other companies is supported by the testimony of an independent witness, John Smith, who testified (Tr. 124):

> "Q. Were you ever requested in '62 to write fire insurance on property for Mrs. Arley in the Reno, Nevada area?
>
> A. Mr. Chaney asked me if I could broker it for him—
>
> MR. PETERSON: Objected to, your Honor, as hearsay as far as the defendants are concerned. I think it is incompetent.
>
> THE COURT: The conversation itself would be. You can answer the question Yes or No.
>
> THE WITNESS: Yes.
>
> MR. PETERSON: I move to strike the answer as given.
>
> THE COURT: The motion is denied.
>
> By MR. ROBERTS:
>
> Q. Who asked you?
>
> A. Roger Chaney."

II

The Fact That an Insurance Agent Is Licensed in the State of Oregon to Represent Named Insurance Companies Does Not Preclude Such Agent From Acting as an Agent or Broker for an Insured.

It is well established in the State of Oregon that a general insurance agent may act as an agent or broker on behalf of an insured. In so doing, such agent or broker assumes duties and responsibilities to his principal, i.e., the insured.

In *Hamacher* v. *Tumy,* 222 Or. 341, 347, 352 P.2d 493, 496 (1960), an action was brought against a gen-

eral insurance agent for failure to procure insurance. The Oregon court stated:

> "The parties are in agreement upon the general proposition that an insurance broker who is employed as agent by the insured to procure insurance owes a duty to his principal to exercise reasonable skill and care to obtain the insurance coverage ordered by his principal."

See also *Rodgers Insurance Agency* v. *Anderson Machinery,* 211 Or. 459, 468, 316 P.2d 497, 501 (1957) wherein it was stated:

> "* * * an insurance agent or broker who for a consideration agrees to procure insurance for another will be liable for any damage resulting from an unjustifiable breach of the agreement."

Therefore, it seems clear that an insurance agent in Oregon may in fact be acting as a broker on behalf of the insured. This is so, even though there is no specific statutory provision for the licensing of brokers. This would merely be a common law arrangement of principal and agent, that is, the insurance agent being the agent of the insured.

This proposition is not unique and is consistent with the statutory laws of the State of Nevada. The Nevada statutes provide that a policy may be negotiated by a licensed nonresident agent or broker. N.R.S. 684.350. "Nonresident broker" is defined by N.R.S. 684.020, subsection (4) as:

> "* * * any person * * * not a resident * * * who, for money, commissions, brokerage or anything of value acts or aids in any manner in any solicita-

tion or negotiation on *behalf of the insured, of contracts* * * *." (Emphasis added)

Appellants state, on page 47 of their brief, that Roger Chaney had previously written insurance on Nevada properties without a Nevada license (Citing Tr. 114 through 116). An examination of the transcript reveals that at the time referred to Chaney was writing insurance for Standard Accident and at that time was not an agent or solicitor for United Pacific Insurance Company.

The question of whether or not an insurance agent licensed in the State of Oregon can write insurance on properties outside the State is not in question. The question is merely whether the person so procuring insurance is acting as the agent of an insurance company or as the agent or broker for the insured. The fact that Chaney was not the holder of a nonresident agent's or broker's license in Nevada for the United Pacific Insurance Company was evidence that he was acting on behalf of the assureds rather than on behalf of the company.

In *Hardwick* v. *State Insurance Company,* 20 Or. 547, 26 Pac. 840 (1891) cited by the appellants, the question of agency was merely held to be a fact question for the jury to determine.

In *Hahn* v. *Guardian Assur. Co.,* 23 Or. 576, 32 Pac. 683 (1893), the question for determination was whether or not the insurance agent was acting on behalf of the insurance company. In that case the agent had held

himself out as the agent of the company and there was no notice to the assureds of any limitation of his authority. Here the evidence is consistent with the verdict of the jury that Chaney was acting on behalf of the Arleys rather than United Pacific Insurance Company.

III

If No Contract of Insurance Was Entered Into Prior to the Time of the Fire, Then the Policy Subsequently Issued Was Void

The facts are undisputed that (1) a fire occurred on the evening of January 15 or early morning of January 16, 1963 (R. 54); (2) that Mrs. Arley knew of the fire and notified Roger Chaney (Tr. 73); and (3) Roger Chaney, possessing this knowledge, attempted for the first time to effect antedated fire coverage to January 12, 1963, by ordering a policy from United Pacific (Tr. 76).

United Pacific has absolutely no liability under the alleged contract which is void ab initio. This was not a renewal of an existing policy.

An agent has no authority to attempt to effect insurance upon property already destroyed and a fire policy written after a loss is not a valid insurance contract. *Gambleman* v. *Mercantile Insurance Company of America,* 90 F. Supp. 472 (D.C. S.D. Cal. 1950); *Celina Mutual Casualty Co.* v. *Baldridge,* 313 Ind. 198, 10 N.E.2d 904 (1937); *Hopkins* v. *Phoenix Fire Insurance Company,* 200 Ky. 365, 254 S.W. 1041 (1923).

In 16 *Appleman Insurance Law Practice,* § 9163, 703 General Rules, it is stated:

> "An agent of an insurance company generally has no authority to bind his principal by attempting to insure property already destroyed. The filling in and delivery of a policy on property known to be already destroyed cannot be treated as a ratification of a prior imperfect contract to insure, ratification by an agent after knowledge of a fire being unauthorized."

In *Waterloo Lumber Company* v. *Des Moines Insurance Company,* 158 Iowa 563, 138 N.W. 504, 506 (1912), the Iowa court stated:

> "It has frequently been held that an agent has no authority to insure property already destroyed and a policy written and intended as a substitute for a subsisting policy in another company, but not delivered or brought to the notice of the property owner until after loss, is not a valid contract of insurance."

See also *United States Casualty Co.* v. *Rodriguez,* 288 S.W. 487, (Tex. Civ. App. 1926); *Clark* v. *Insurance Company of North America,* 89 Me. 26, 35 Atl. 1008 (1896); *Hopkins* v. *Phoenix Fire Insurance Co.,* supra; *Alliance Insurance Co.* v. *Continental Gin Co.,* 285 S.W. 257 (Tex. Com. App. 1926); *Sholund* v. *Detroit Fire & Marine Ins. Co.,* 172 Wn. 111, 19 P.2d 395 (1933); *Royal Ins. Co. Ltd.* v. *Smith,* 77 F.2d 157 (C.A. 9 1935); *Ernest* v. *State,* 40 Ala. App. 344, 113 So. 2d 517 (1959).

Thus, if there was no previous contract of insurance between Arleys and United Pacific Insurance Company, no valid contract of insurance could have been entered into subsequent to the date of the fire irrespective of whose agent Chaney was on that date.

PROCEDURAL ISSUES

IV

Venue Was Properly Laid in The District of Oregon.

The record is clear that the Arleys have resided in Portland, Oregon, since 1958 (Tr. 179). Mr. Arley was employed in Portland by the Montag Furnace Company and maintained his bank account in Portland (Tr. 180, 181). Their automobiles are licensed in Oregon (Tr. 180).

Citizenship for diversity purposes means domicile. *Seideman* v. *Hamilton,* 173 F. Supp. 641 (D.C. Penn. 1959). The domicile of the wife is generally considered to be that of her husband. *Seideman* v. *Hamilton,* supra; *Price* v. *Greenway,* 167 F.2d 196 (C.A. 3 1948); Restatement, Conflict of Laws, § 27 (1934).

V

The Court Properly Submitted The Case to the Jury as an Action for Declaratory Judgment.

It is remarkable that the appellants now urge that the Court erred by treating this case as one for declaratory judgment and submitting it to a jury when this was the expressed desire of appellants throughout the pleading and pretrial procedure.

The appellants in Paragraph X of the pretrial order (R. 58) stated: "If defendants are compelled by this

Court to file a counterclaim the issues raised by said counterclaim and any assertable defenses thereto are triable by jury as a matter of right prior to any determination of the issues raised in plaintiff's suit."

The Court in compliance with the appellant's demands at the commencement of the trial advised (Tr. 2) "I feel that under the declaratory judgment statute you have a right to a jury trial on any issues of fact. That is what you are going to get. You are going to get a jury trial on that. * * *"

The appellants have urged that they were prejudiced by the Court trying the matter of agency and liability under the policy as a segregated issue pursuant to Rule 42(b) of the Federal Rules of Civil Procedure.

The question of the agency of Roger Chaney was common both to the appellants' counterclaim and the appellee's action for rescission of the policy or defense to the counterclaim. The action followed by the Court in this case was consistent with Rule 42(b) and is an example of the application of such rule to simplify the issues and avoid protracted litigation.

The submission of these matters to the jury preserved the appellants' rights to trial by jury and makes moot their claim as to which issue should have precedence in the trial.

Appellants' reliance upon *Bruckman* v. *Hollzer*, 152 F.2d 730 (C.A. 9 1946) and *Beacon Theatres Inc.* v. *Westover*, 79 Sup. Ct. 948, 350 U.S. 500 (1959) is misplaced as the thrust of each case was the denial of

a right to trial by jury. Here the Court did submit the matter to a jury. In fact, the *Beacon* case is illustrative of the liberal use that should be made of Rule 42(b). The Supreme Court in that case stated at page 955:

> "Under the Federal Rules the same Court may try both legal and equitable causes in the same action. Fed. Rules of Civ. Proc. 1, 2, 18. Thus any defenses equitable or legal, Fox may have to charges of antitrust violations can be raised either in its suit for declaratory relief or in answer to Beacon's counterclaim. * * * In this way the issues between these parties could be settled in one suit giving Beacon a full jury trial of every antitrust issue."

Appellants further argue that the Court erred in failing to stay the action in Oregon and transfer the proceedings to Nevada. The cases cited by the appellants involved in each instance an exercise of the sound discretion by the Court as to whether or not it should retain jurisdiction. Generally in the cases where jurisdiction was declined there had been a previous action pending in the other district.

Here the Court properly exercised its discretion in retaining jurisdiction in Oregon—where the controversy on the fire coverage was first litigated. At the time of appellants' motion (R. 36, 37) the District Court in Nevada had previously stayed the Nevada proceedings. This is reflected in the Court's ruling (R. 41, 42):

> "* * * Further the proceedings in this cause have progressed to the stage where a pretrial order has been prepared and the cause seems to be at issue and ready for trial. On the other hand, the

> action in the District Court for the District of Nevada is not at issue, the Nevada Court on the 15th day of April, 1964, having entered an order granting a stay of proceedings on account of the pendency of this action, * * *."

Considering the state of the record, the fact that the principal parties, i.e., Mr. and Mrs. Arley and principal witnesses, i.e., Roger Chaney, Larry Nelson, John Smith, Linda Upton, Robert Mohlere and A. D. Reinhardt, resided in this district, the Court was entirely within its discretion in retaining jurisdicton.

The appellants have complained that the complaint was entitled as one in equity for rescission and that therefore the subsequent legal action filed in Nevada should take precedence. The Federal Rules of Civil Procedure, Rule 2, Provide that there should be one form of action to be known as a civil action.

The only distinction of substance remaining between actions at law and suits in equity is in determining whether a party is entitled as a matter of right to trial by jury. *Chichester* v. *Kramer,* 157 F. Supp. 79 (D.C. N.Y. 1957). Here this question is moot as the jury determined all facts involved in the segregated trial.

Upon learning the true facts the course of United Pacific Insurance Company was clear. It must act with dispatch so as to not mislead the appellants and to avoid waiving its rights to relief. Speedy determination of the controversy was for the benefit of all parties concerned.

The jurisdiction of this Court to entertain the ac-

tion by United Pacific is clear as the State of Oregon has recognized mistake as the basis for rescission. *State Highway Commission* v. *State Construction Co.*, 203 Or. 414, 280 P.2d 370 (1955); *G. E. Supply Corporation* v. *Republic Construction Corp.*, 201 Or. 690, 272 P.2d 201 (1954).

In *Parker* v. *Title and Trust Company,* 233 F.2d 505 (C.A. 9, 1956), the District Court in Oregon took jurisdiction of an equity suit for rescission of a title insurance policy. In affirming the retention of jurisdiction the appellate court stated at page 508:

> "In the first place, the title company clearly acted under a mistake of fact and in ignorance of the very material lack of title to lot 2. This was a case of unilateral mistake, but the mistake was known to the Parkers who were fully aware that it concerned a matter so vital that the policy would not have been issued were it not for the mistake. The Supreme Court of Oregon has held that under such circumstances a contract is subject to cancellation in equity."

From the very beginning the appellee has contended that it would not have issued the policy of insurance if the appellants had disclosed the damage to the property (R. 2) and that the policy of insurance issued by the appellee was issued and executed under a mistake of fact as to the existence of the subject matter (R. 3).

Appellee contended in the pretrial order (R. 55, 56) "That the policy of insurance was issued by the plaintiff under a mistake of fact. Plaintiff believing that said

property was in existence and in good condition at the time the policy was requested."

There is no question that the Arleys knew that the property had been previously destroyed on January 17th when the application for insurance was submitted to the United Pacific Insurance Company by Roger Chaney (Tr. 73).

The cases cited by appellants for the proposition that the Court should have declined jurisdiction are cases in which rescission was sought solely on the grounds of fraud in the procurement of the policy.

THE INSTRUCTIONS

VI

The Court Properly Instructed the Jury as to the Elements Required to Establish an Oral Contract of Insurance.

We fail to understand appellants' argument under Point VII as directed to specification of error numbers 33 and 38. The language used by the court in giving its instruction as to the naming of United Pacific Insurance Company (appellants' specification of error 38) is identical to the language requested by the appellants in its alternative instruction No. 3 (specification of error 33) in respect to the naming of the insurance company.

But in any event, no error was committed by the court in its instruction in this respect. It is well established that there are certain stringent standards requi-

site to proof of an oral contract of insurance. The parties must agree to certain minimal terms including the name of the insurer, the amount of the premium, specification of the risk and the duration of the risk. The minds of the parties must meet intending to make a valid oral contract. 12 *Appleman Insurance Law Practice,* § 7196, p. 270; *Cerino* v. *Oregon Physicians Service,* 202 Or. 474, 484 et seq., 276 P.2d 397 (1954); *Bird* v. *Central Manufacturers Mutual Insurance Co.,* 168 Or. 1, 120 P.2d 753 (1942); *Cleveland Oil Co.* v. *Norwich Ins. Society,* 34 Or. 228, 55 Pac. 435 (1898).

The law in the State of Oregon is more stringent in respect to fire insurance policies than other types of insurance. In *Salquist* v. *Oregon Fire Relief Assn.,* 100 Or. 416, 197 Pac. 312 (1921) the Oregon Supreme Court held that oral contracts of fire insurance were not binding because of the statutory requirement (now O.R.S. 744.100) that specific forms of provisions must be incorporated in all fire policies as a prerequisite to validity. This was cited in the more recent case of *Mock et al* v. *Glens Falls Indemnity Co.,* 210 Or. 71, 80, 309 P.2d 180, 184 (1957) to the effect:

> "It is settled that a sufficiently definite oral agreement of insurance, by a general agent, is valid in this state * * * at least in the absence of a required statutory form of policy (*Salquist* v. *Oregon Fire Relief Assn.* * * *)."

In any event when an agent represents more than one insurance company none of them is bound by oral contract until the agent allocates the risk. *Sholund* v. *Detroit Fire & Marine Ins. Co.,* supra. Here Chaney at-

tempted to broker the insurance through other companies (Tr. 13, 70, 71, 124) and it was *not until after the loss* that he attempted to bind United Pacific (Tr. 75).

VII

The Court Correctly Instructed the Jury and Appellants' Specification of Error 30, 31, 32, 34, 35, 36, 37 and 39 Are Without Foundation.

Appellants' requested instructions No. 1 and No. 2 (specification of error 30, 32) do not correctly state the law. Certain minimal terms must be set forth including name of insurer, premium, risk, and duration. *Cerino* v. *Oregon Physicians Service,* supra; *Bird* v. *Central Manufacturers Mutual Insurance Co.,* supra; *Cleveland Oil Co.* v. *Norwich Ins. Society,* supra; 12 *Appleman Insurance Law Practice* Sec. 7199, p. 285.

No error was committed in failing to give appellants' instruction No. 2 (specification of error 31). Roger Chaney did not receive a commission from United Pacific (Tr. 70) as contrasted with *Williams* v. *Pacific States Fire Ins. Co.,* 120 Or. 1, 251 Pac. 258 (1926) cited by appellants. That case held that agency was a fact question for the jury.

The appellants' requested instruction No. 4 (specification of error 34) does not correctly state the law. If the loss occurred prior to application or issuance of the policy, such policy is void. See Point III of appellee's argument.

The Court's outline of the plaintiff's contention (ap-

pellants' specification of error 35) is consistent with the pretrial order (R. 56). The date was misstated as the 16th rather than the 17th. The Court offered to reinstruct the jury but the appellants stated they were not making an issue of this (Tr. 267). There is no evidence that Nelson knew that Chaney filed the application with United Pacific without disclosing the loss (Tr. 16).

In respect to specification of error 36, if the use of the word "broker" was error it was cured by the Court's instruction "* * * Whenever I mentioned 'broker' during the course of the instructions you will consider that I was speaking of an agent."

Specification of error 37 is not well taken. Avoidance of the policy for "wilful concealment" of a material fact is an express provision of the insurance contract (R. 5). The fact that Nelson may have known of the loss does not affect the result, as even a general agent has no authority to place insurance on property previously destroyed. However, Nelson did not know that Chaney submitted an application without disclosing that the property had been damaged (Tr. 16).

Appellants in specification of error 39 urge that the Court's comments on the evidence was an erroneous statement as to the law of brokerage. No authority is needed for the proposition that a trial judge in a federal court has broad discretion in his powers to comment on the evidence. However, the appellants have misinterpreted the Court's comments. The evidence mentioned certainly had to be considered by the jury in determining whether Chaney had in fact placed coverage with United

Pacific Insurance Company prior to the loss. This was properly considered by the jury and the jury found for the appellee.

CONCLUSION

Appellee respectfully submits that: (1) the evidence supports the Verdict of the jury.

(2) that the instructions of the Court properly framed the issues to be considered. That the evidence supports the conclusion that Roger Chaney during the period in question was acting as the agent of appellants and not of appellee, and that there was no contract of insurance between Arleys and United Pacific in effect prior to the fire.

(3) that as a matter of law the insurance policy which was issued subsequent to the loss was void and of no force and effect.

That the verdict and judgment of the District Court should be affirmed in all respects.

Respectfully submitted,

MAUTZ, SOUTHER, SPAULDING,
KINSEY & WILLIAMSON and
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ROCKNE GILL
Attorneys for Appellee

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROCKNE GILL
Of Attorneys for Appellee

No. 20099

United States
Court of Appeals
for the Ninth Circuit

JACQUES ARLEY and CHARLOTTE ARLEY,
husband and wife,

Appellants,

v.

UNITED PACIFIC INSURANCE COMPANY,
a Washington corporation,

Appellee.

Appeal from the United States District Court
for the District of Oregon

BRIEF FOR APPELLANTS

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No. 20099

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JURISDICTION

This litigation was initiated by United Pacific Insurance Company, appellee, on a civil complaint in equity to rescind a fire policy issued to Jacques Arley and Charlotte Arley, appellants, on property near Verdi, Nevada.

Jurisdiction is based upon diversity of citzenship (28 U.S.C. sec. 1332). It is admitted that United Pacific Insurance Company is a Washington corporation and that the sum in controversy exclusive of interest

and costs exceeds $10,000. (pretrial order, R. 53, 54). Appellants are not citizens of the state of Washington. (Tr. 181).

The trial court of its own initiative and with a jury impanelled to determine the question of liability on the policy tried appellee's suit as an action for declaratory judgment. (Tr. 6). The jury returned a general verdict for appellee on December 17, 1964 (R. 63) On December 23, 1964, appellants filed a motion for judgment notwithstanding the verdict, or alternatively for a new trial (R. 64-66). Judgment was entered on December 23, 1964 (R. 68, 69). Appellants' motion was denied on February 2, 1965 (R. 71, 72). Notice of Appeal was filed on February 26, 1965 (R. 73). Jurisdiction of this court to review the judgment is based upon 28 U.S.C. sec. 1291.

STATEMENT OF THE CASE

The Facts

Appellants are husband and wife and were married in 1954 (Tr. 245). On September 10, 1955, they purchased real property near Verdi, Nevada, consisting of a two story frame dwelling with adjacent guest house. The initial fire coverage on this property was obtained through an insurance agency in Reno, Nevada (Tr. 182, 216). Appellants also own real property in Sparks, Nevada (Tr. 62).

Sometime in 1958, appellant Jacques Arley became associated with Montag Furnace Company in Portland, Oregon, and appellants rented an apartment there. (Tr. 179, 180). Appellant Charlotte Arley retained her membership in the Nevada State Bar and continues to vote in Nevada (R. 9, Tr. 60, 181). Jacques Arley is not registered to vote (Tr. 181).

Early in 1958 appellants were introduced to Roger Chaney through an employee of Liberty Mutual Insurance Company who carried some of their coverage (Tr. 217). Mr. Chaney was an insurance agent whose agency was the R. A. Chaney Company, writing all lines of insurance. (Tr. 59). Over a period of time Mr. Chaney wrote appellants' coverage for auto, fire, liability, life, health & accident and floater policies. (Tr. 61, 217). Fire policies on both Nevada properties were written by Standard Accident Insurance Com-

pany, through Mr. Chaney, effective January 28, 1958, for a period of three years. Verdi coverage was for $15,00.00 on the main dwelling and $5000.00 on the guest house. The Sparks policy was cancelled in October 1960, and the Verdi policy was cancelled effective November 25, 1960, with notice of cancellation going to Roger Chaney (Tr. 62, 63, 85).

On January 1, 1961, R. A. Chaney merged its business with the Larry C. Nelson General Agency. Mr. Chaney transferred all of his accounts, including the policies of Jacques and Charlotte Arley, to the Larry Nelson Agency (Tr. 11, 12, 83). Mr. Chaney continued to handle the Arley account (Tr. 39, 50, 233). Commissions on all new business were shared by Nelson and Chaney on a fifty-fifty basis. (Tr. 25).

On or about October 30 or 31, 1962, Mr. Chaney delivered a floater policy to Mrs. Arley (Tr. 89). Mrs. Arley was preparing to leave for Reno. She told Mr. Chaney she had discovered there apparently had been no coverage on the Verdi property during 1961 and that she would place coverage either with Mr. Greenspan in Reno or with Mr. Chaney (Tr. 187, 188.) Mrs. Arley stated she did not want to be covered in Standard Accident or in another mutual company. (Tr. 90, 187). Mr. Chaney said they had a good northwest outfit and that he would cover her effective immediately with United Pacific Insurance Company (R. 89-91, 100, 188). Mrs. Arley gave Mr.

Chaney the Standard Insurance Company memorandum of insurance on the Verdi property, told him it was to be the same except that coverage on the main house was to be increased by $2500 because of improvements that had been made (Tr. 54, 55, 68, 91, 187, 188). Mrs. Arley left for Reno and relying on what Mr. Chaney had told her made no attempt to obtain coverage in Reno. She returned to Portland on November 24, 1962 (Tr. 221, 224). Sometime in middle December, 1962, Mr. Chaney again told her she was covered (Tr. 92, 93, 225, 226).

In the early hours of January 16, 1963, fire destroyed the main dwelling. Mrs. Arley reported the loss to Mr. Chaney and asked if she should confirm this notice in writing to the company. Mr. Chaney said he was the agent, this was unnecessary and that he would go right over there (Tr. 192, 193).

On or about March 5, 1963, appellants received by mail from the Larry Nelson Agency, United Pacific Insurance Company policy F78185 (Def.'s Exh. No. 52) together with Mr. Nelson's statement for the policy premium. (Def's Exh. No. 57). Appellants forwarded their check dated March 9, 1963 to Nelson for the premium (Tr. 229).

Earlier Mrs. Arley had been in Reno to inspect the loss with the General Adjustment Bureau adjuster.

Her time for filing proof of loss was extended until the middle of April, 1963 (Tr. 229-231).

By letter dated April 2, 1963, United Pacific Insurance Company wrote to appellants denying coverage on the following grounds: (Pl. Exh. 56)

> "As you know, without any disclosure to the Company, the property for which coverage was requested had been damaged by fire prior to the time the application for insurance was made or any policy issued. Therefore, under the circumstances, such policy is void and of no force and effect and is rescinded as of its inception date.
>
> "Even if this was a valid policy, which we emphatically deny, it appears that your refusal to give a statement under oath concerning the loss, as would be required by the terms of this and any standard fire policy would breach the conditions and further invalidate any alleged existing policy."

Background of Litigation

On April 4, 1963, United Pacific Insurance Company filed its complaint in equity in the United States District Court for the District of Oregon to rescind its policy. (R. 1-4).

On April 30, 1963, appellants filed a motion to dismiss for improper venue (R. 8).

On May 1, 1963, appellants moved to require ap-

pellee to set forth with particularity the "mistake" alleged in their complaint. (R. 11, 12).

On June 10, 1963, appellee filed its amended complaint (R. 16).

On June 20, 1963, appellants filed a motion to dismiss the amended complaint on the ground it failed to state a claim upon which relief could be granted, there being no allegation of lack of a plain, speedy and adequate remedy at law. (R. 21, 22)

On July 5, 1963, appellants filed an action at law on the policy in the Second Judicial District Court of the State of Nevada, in and for the County of Washoe. (R. 30)

On July 29, 1963, United Pacific Insurance Company petitioned to remove said action at law to the United States District Court for the District of Nevada (R. 31).

On July 30, 1963, appellants filed their answer to appellee's amended complaint, affirmatively alleging improper venue and want of equity. (R. 25, 26)

On October 25, 1963, appellants filed a motion for summary judgment for want of equity (R. 28-33).

On April 17, 1964, appellants filed a motion to stay

proceedings or in the alternative to transfer to the District of Nevada. (R. 36-39).

On April 13, 1964, the Nevada Court entered an order granting a stay of proceedings on account of the pendency of the Oregon action (R. 42)

On July 20, 1964, appellants moved for certification under 28 U.S.C. section 1292(b) on the question whether an adequate remedy at law is lacking. (R. 43-46).

On August 11, 1964, the Court ordered appellants to file their counterclaim (R. 48, 49).

On October 1, 1964, the court advised counsel by letter that the court was "giving serious consideration to submitting to a jury all of the issues of fact in this case."

Pre-trial order was lodged on September 29, 1964. (R. 53-62, 90).

On December 11, 1964, appellants moved for summary judgment on the ground appellee was estopped to deny the validity of its policy because it was procurred through its authorized agent. (R. 50).

All of appellants' motions were denied.

The pre-trial order was filed on December 15, 1964. (R. 53).

The case was tried on December 15-17, 1964, as an action for declaratory judgment with a jury impanelled by the court (Tr. 1).

At the close of trial appellants moved for a directed verdict. (Tr. 251).

The jury returned a general verdict for appellee. (R. 63).

On December 23, 1964 appellants filed a motion for judgment notwithstanding the verdict, or alternatively for a new trial. (R. 64-66).

On December 23, 1964, the court adopting the verdict of the jury entered judgment for appellee (R. 69).

Appellants' motions for new trial and for judgment notwithstanding verdict, were denied on February 2, 1965. (R. 71, 72).

THE CONTROVERSY

The ultimate question in this case is whether the court should have dismissed appellee's suit.

The case having been tried, an additional question presented is whether appellants were denied their constitutional right to trial by jury by the method of trial.

A further question raised is whether under Oregon law a licensed solicitor may act as a broker for an assured.

Appellants contend that equity jurisdiction was lacking and that the court should have dismissed appellee's suit, allowing appellants to proceed in their pending action at law.

The court held it had equity jurisdiction (R. 48, 49), and by its judgment entered December 23, 1964, ordered "that the policy of insurance No. F 78185, issued by plaintiff to defendants be, and the same is hereby, cancelled, rescinded and held for naught; and that defendants' counterclaim be, and the same is hereby, dismissed with prejudice." (R. 69).

Appeal is from the Judgment of the Court.

SPECIFICATIONS OF ERROR

The basic error of the trial court was in failing to dismiss appellee's suit for want of equity. It was additional error for the court of its own motion to try appellee's suit as an action for declaratory judgment with a jury to try out the issue of liability on the policy, instead of allowing appellants to proceed with a common law jury in their pending action at law. (Tr. 2).

The court stated after trial, in its judgment dated December 23, 1964, that the cause was submitted to the jury as an action at law, but if in the event of appeal the Court of Appeals should hold that this cause should have been tried as a suit in equity, the court was in full agreement with the jury on the issues submitted. (R. 68, 69). The specification of error which follow are based on this posture of the case.

1. The court erred in denying appellants' motion to dismiss for improper venue. (R. 8, 14).

2. The court erred in denying appellants' motion to require appellee to set forth the circumstances constituting the alleged mistake. (R. 11, 12, 14).

3. The court erred in denying appellants' motion to dismiss appellee's amended complaint for failing to state a claim upon which relief could be granted or in the alternative to strike. (R. 21, 24).

4. The court erred in denying appellants' motion for summary judgment for want of equity. (R. 28-33, 35).

5. The court erred in denying appellants' motion to stay proceedings or in the alternative to transfer to Nevada. (R. 36-39, 41-42).

6. The court erred in denying appellants' motion for certification under 28 U.S.C. section 1292(b). (R. 43-46, 48-49).

7. The court erred in requiring appellants to file their counterclaim on the policy (R. 49).

8. The court erred in denying appellants' motion for summary judgment made on the ground that the policy issued was procured through a licensed agent of the company. (R. 50-51, Tr. 4).

9. The court having required appellants to file their counterclaim erred in trying appellee's suit to cancel, prior to the counterclaim at law. (Tr. 2).

10. The court erred in denying appellants' motion for summary judgment on the opening statement of counsel for appellee. (Tr. 36).

11. The court erred in overruling appellants' contention that no defense was available to appellee except its asserted allegation that defendants had failed to disclose to plaintiff that the property had been

damaged by fire prior to the time application for insurance was made, as stated in its letter of April 2, 1963. (Pretrial order, paragraph V, R. 57) .

12. The court erred in denying appellants' motion for a directed verdict. (Tr. 251).

13. The court erred in failing to submit special interragotories to the jury. (Tr. 253).

14. The court erred in adopting the verdict of the jury. (Judgment, R. 68, 69).

14(a) The court erred in failing to make findings of fact and conclusions of law.

15. The court erred in entering judgment for appellee, and making the following order therein:

> "that the policy of insurance No. F 78185, issued by plaintiff to defendants be, and the same is hereby, cancelled, rescinded and held for naught; and that defendants' counterclaim be, and the same is hereby, dismissed with prejudice." (R. 69).

16. The court erred in denying appellants' motion for judgment notwithstanding the verdict, or alternatively, for a new trial. (R. 64-66, 71, 72).

17. The court erred in admitting over appellants' objection as being incompetent, testimony of Mr. Nelson that Mr. Chaney had come to him in early sum-

mer 1962 and asked that insurance be placed on the Verdi property, and that Mr. Nelson told Chaney they couldn't do it because they had no nonresident license for Nevada. (Tr. 13, 14).

18. The court erred in admitting over appellants' objection as being immaterial testimony of Mr. Chaney that Mr. Nelson's nonresident's license had expired just about the time Mrs. Arley had requested Chaney to place coverage in the summer of 1962. (Tr. 69).

19. The court erred in admitting over appellants' objection as being hearsay, Mr. Chaney's testimony that he called another insurance company and a general agency about getting the Arleys' business placed (Tr. 70).

20. The court erred in admitting over appellants' objection that United Pacific was a corporation and could act only through its agents, Mr. Chaney's testimony that at the time he ordered the policy he had not told "United Pacific" the property had been damaged. (Tr. 76).

21. The court erred in admitting over appellants' objection that it was not competent or material and that United Pacific was estopped to assert or to alter the terms of the policy, testimony of Mr. Chaney that when he ordered the policy, not having taken care of placing the business, he asked to have the policy dated

effective January 12, 1963, because in order to have the loss covered, the policy had to be dated something beyond the 15th." (Tr. 76, 77).

22. The court erred in admitting over appellants' objection, testimony of Mr. Chaney that his reason for asking Mr. Nelson whether he, Chaney, could write insurance on the Verdi property was strictly a matter of the nonresident license and their being unable to participate in the commission. (Tr. 99).

23. The court erred in admitting over appellants' objection as hearsay and incompetent, testimony of John Smith that Roger Chaney had asked if Smith would write fire insurance on the Arley property (Tr. 124).

24. The court erred in admitting over appellants' objection as incompetent, testimony of Linda Upton, former policy writer for appellee, that when the memorandum for coverage came to her desk, she had no knowledge of any loss (Tr. 131).

25. The court erred in admitting over appellants' objection as hearsay and incompetent, testimony of Mr. Courtney, staff claims adjuster for appellee, that on January 17, 1963, Chaney had told Courtney that he, Chaney, had a serious problem and needed help; that he had been too busy with windstorm claims and had overlooked it or hadn't gotten around to it, but had

allowed a very important risk to lapse by about eleven days. That he had heard there had been about a fifty dollar loss on this property in Nevada and he asked Courtney if he would bind coverage for him to cover this loss. Courtney told Chaney to go to the underwriters (Tr. 144).

26. The court erred in admitting over appellants' objection as having occurred after the loss and incompetent, testimony of Mr. Marks, GAB adjuster, that he first got the assignment of claim from Mr. Chaney on March 5, 1963. (Tr. 166).

27. The court erred in admitting over appellants' objection as incompetent, testimony of Mr. Reinhard, claims manager of appellee, that he did not know that Mr. Chaney had assigned the claim to General Adjustment Bureau (Tr. 177).

28. The court erred in admitting over appellants' objection as not competent appellee's Exhibit 8, the United Pacific Insurance Co., file. (Tr. 149, 152, 213).

29. The court erred in refusing to admit in evidence appellants' exhibit 54, the Standard Accident memorandum of insurance on the Sparks property, to indicate that the memorandum Mrs. Arley handed Mr. Chaney on October 30 or 31, 1962, was the memorandum on the Verdi property. (R. 250).

29 (a). The court erred in sustaining appellees objection to the admission of Roger Chaney's testimony which would have stated whether Roger Chaney could have done in October or November of 1962, exactly what he did in January, February and March of 1963. (Tr. 98).

30. The court erred in failing to give appellants' requested instruction No. 1, as follows:

> You are instructed that the plaintiff United Pacific Insurance Company is a corporation, organized and existing under and by virtue of the laws of the state of Washington. Under the admitted facts in this case, United Pacific Insurance Company was licensed to engage in the sale of fire insurance policies for premiums paid to the plaintiff by purchasers of fire insurance policies within the state of Oregon and within the state of Nevada.
>
> Under the undisputed evidence in this case, the witness Larry C. Nelson at all times material, was a duly licensed insurance agent of the state of Oregon. Under the undisputed evidence in this case, also the witness Roger A. Chaney was a duly licensed insurance solicitor of the state of Oregon.
>
> You are instructed that under the law United Pacific Insurance Company had legal authority to sell fire insurance upon property located either in the state of Oregon or the state of Nevada. (*Hahn v. Guardian Assurance Co.,* 23 Or 576). Therefore, if you find that the witness Roger Chaney agreed with the defendants Jacques Arley or Charlotte Arley to cover dwellings of the de-

fendants located within the state of Nevada, then your verdict will be in favor of the defendants since the witness Roger Chaney would be the agent of the United Pacific Insurance Company.

31. The court erred in failing to give appellants' requested instruction No. 2, ar follows:

It is contended by the plaintiff United Pacific Insurance Company that Roger Chaney was the agent of the defendants Mr. and Mrs. Arley. In this respect, if you find from the evidence in this case that Larry C. Nelson Insurance Agency had an agreement or arrangement with the United Pacific Insurance Company, the plaintiff, whereby Larry C. Nelson was to be paid commissions upon business that Larry C. Nelson or Roger Chaney brought to the plaintiff United Pacific Insurance Company, and that United Pacific Insurance Com pany was accustomed to write policies of insurance upon risks solicited by Larry C. Nelson Agency, or by Roger Chaney, and that Larry C. Nelson delivered the policy of fire insurance covering the defendants' property located near Verdi, Nevada, then you will find that said Roger Chaney was the agent of the plaintiff insurance company, and not the agent of the defendants, or either of them. (*D. C. Williams, et al. v. Pacific States Fire Ins. Co.,* 120 Or 1 at 7, 251 P 258 at 260, 29 Am Jur Sec. 136 at p. 538, 539, 540).

32. The court erred in failing to give appellants' requested instruction No. 3, as follows:

If you find that the witness Roger A. Chaney orally advised defendant Charlotte Arley that the dwelling house that she and her husband owned

near Verdi, Nevada, was covered by fire insurance, then such statement on the part of Roger A. Chaney would be binding on United Pacific Insurance Company and a contract of insurance would be thereby created which would be binding on United Pacific Insurance Company.

33. The Court erred in failing to give appellants' alternative requested instruction No. 3, as follows:

> In this case, if you find that Roger A. Chaney before January 15, 1963, told Mrs. Charlotte Arley that the buildings owned by Mr. and Mrs. Arley near Verdi, Nevada were covered by fire insurance and named the United Pacific Insurance Company as the fire insurance company that would issue the policy, then I instruct you that your verdict must be in favor of the defendants, since the policy of insurance issued on the property would be completely binding on United Pacific Insurance Company and in the event of a fire loss, the defendants would be entitled to be paid by United Pacific Insurance Company for their loss. (*Western National Ins. Co. v. LeClare,* 163 F2d 337 (9th Cir 1946).

34. The court erred in failing to give appellants' requested instruction No. 4, as follows:

> You are instructed that United Pacific Insurance Company in the instant case cannot be permitted to void the policy by taking advantage of any misstatement, misrepresentation or concealment, of a fact material to the risk, which is due to the mistake, fraud, negligence or other fault of its agent and not to fraud or bad faith on the part of the insured, who are the defendants Mr.

> and Mrs. Arley. That is to say, if you find that there was any failure to disclose to United Pacific Insurance Company that a fire loss had occurred before the insurance policy had been issued, such failure to disclose would have no effect upon the validity of the policy of insurance since Roger A. Chaney was the agent of United Pacific Insurance Company. (*Williams v. Pacific States Fire Ins. Co.* 120 Or 1 at p 10, 251 P 258, 261).

The objection urged in the courts failing to give the foregoing instructions was that they were based upon the Oregon cases on the subject. (Tr. 265).

35. The court erred in stating the contention of the insurance company as follows:

> "Now I will outline the contentions of the parties here. Generally speaking, it is the plaintiff's contention, that is, the United Pacific Insurance Company, that at the time this application for insurance was made by Roger Chaney on the 16th of January, he was acting as broker and agent for the defendants here in attempting to secure this insurance on this property rather than for the plaintiff, and that at the time of making this application to the plaintiff insurance company for this coverage he had knowledge that this property had already been destroyed by fire, and that he wilfully concealed and did not disclose the fact to the insurance company at the time the application for insurance was made.
>
> "In other words, the plaintiff claims that Chaney under those conditions was acting as agent for the defendants and not as agent for the plaintiff. (Tr. 255, 256).

The objection urged was that the loss occurred on Janurary 16, and that Larry Nelson, the company's agent, had testified that he, Nelson, knew that the loss occurred on January 16. The application was not made until the following day, January 17. (Tr. 265-267).

36. The court erred in instructing the jury as follows:

> "Now, the principal issue to be decided by you in this case under the issues as formulated is whether Chaney, who had been named as solicitor by the Nelson Company, was during Chaney's discussions with Mrs. Arley on the 30th or 31st of October, 1962, acting for the defendants or was he acting for the plaintiff in the scope of his authority as solicitor for Nelson? The fact that Chaney may have been named as a solicitor for the plaintiff is not in and of itself controlling. You must weigh all of the evidence in the case and determine therefrom whether Chaney was in truth and in fact acting as a broker attempting to secure insurance for the defendants, or was in truth and in fact acting for the plaintiff. If Chaney was acting for the defendants in procuring this insurance then your verdict must be for the plaintiff. When I say 'in procuring this insurance', I mean if he was acting at the time he made this application on January 16th as agent for the defendants, then your verdict must be for the plaintiff. (Tr. 258, 259).

The objection urged was that under the statutes of Oregon, there can be no broker. Therefore Mr. Chaney could not act as a broker, that the statutes provide

for a licensed agent, a licensed solicitor and for only a nonresident broker.

A second objection was that under the law of Oregon an agent licensed in the State of Oregon to write insurance has authority to write insurance on property any place outside the state. (Tr. 268).

37. The court erred in instructing the jury as follows:

> "Now, if you find from a preponderance of the evidence that Chaney was the agent of the defendants in the attempt to procure this insurance, and failed to reveal to the United Pacific Insurance Company and wilfully concealed from the company the fact that the property had been damaged by fire prior to the written request to United Pacific Insurance Company for insurance on the property, then your verdict should be for the plaintiff, the United Pacific Insurance Company. (Tr. 260, 261).

The objection urged was that even if it could be possible for Chaney to act as a broker, it would not make any difference because the agent with whom he placed coverage was Larry Nelson, who, under the terms of the contract was in effect the United Pacific Insurance Company. (Tr. 269, 270).

38. The court erred in instructing the jury as follows:

> "If, on the other hand, you find that Chaney, on

> or about October 30th or 31st, 1962, while acting within the scope of his authority with the Nelson Company, represented to the defendant Mrs. Arley that the buildings owned by the defendants near Verdi, Nevada, were covered by fire insurance and named the United Pacific Insurance Company as the fire insurance company that would issue the policy, and that the amount and date of the coverage was definite, and that the issuance of the policy here in question was the outgrowth of said representations, if any, then and in that event your verdict should be in favor of the defendants on the issues here presented." (Tr. 261).

The objection urged was that under the undisputed evidence Mr. Nelson and Mr. Chaney had no company in which they could write fire insurance except United Pacific and therefore the principal didn't have to be named. (Tr. 269).

39. The court erred in commenting on the evidence as follows:

> "On these questions, your attention is called to the admission of Chaney and the testimony of Nelson to the effect that after the October conversation Chaney was told by Nelson that he did not have authority to write insurance in Nevada, and that Chaney attempted to place the insurance with other firms. This, of course, would have some bearing on whether Chaney made a definite commitment to Mrs. Arley to cover the property in the United Pacific Insurance Company for the sums mentioned on the 30th or 31st of October. Tr. 261).

The objection urged was that this is an incorrect statement of the law as to brokerage. (Tr. 269).

SUMMARY OF ARGUMENT

The trial court lacked equity jurisdiction in this case. The court should have dismissed the case or in the alternative should have transferred it to the District of Nevada.

The court had no power to compel appellants to file their counterclaim on the policy, but having required it, should have heard the counterclaim as a separate trial with a common law jury prior to hearing appellee's suit in equity. It was the *only* way in which the court could have protected appellants' right to jury trial.

The character of appellee's suit could not be changed by treating it as an action for declaratory judgment. The court could not thus enlarge its equity jurisdiction. Assuming jurisdiction was not wanting, appellee was not seeking any declaration of rights or liabilities *under* the policy. It was seeking rescission on the ground *the policy never existed.* This was the relief the court granted. It could do this only as a court sitting in equity. A federal court cannot cancel a policy for fraud by a judgment at law.

The relief granted was equitable relief; the jury had to be an advisory jury. The character of

the jury could not be changed to a common law jury by trying the action as though it were an action on the policy and by submitting to the jury issues which would normally be tried out in such an action.

The trial of the case should have been limited to whether or not there was fraud in the procurement of the policy, the *only* ground on which appellee sought rescission. The issues of Roger Chaney's authority and proof of the elements of an oral contract were issues not made by the pleadings. Whether Roger Chaney could be a broker was a question of law and should not have been submitted to the jury. Appellee was estopped to deny its agent and its policy.

I

IS AN INSURER ENTITLED TO MAINTAIN IN A FEDERAL COURT A SUIT IN EQUITY TO CANCEL A STANDARD FIRE POLICY AFTER LOSS HAS OCCURRED ON THE CHARGE THAT THERE WAS FRAUD IN ITS PROCUREMENT.

The court was of the opinion that "a Court of equity would have jurisdiction" (R. 35).

Directed to Specification of Error Nos. 3, 4, 6, 7, 10, 12, 16

The Supreme Court of the United States as early as 1871, in affirming the dismissal of the complaint in a suit to cancel life insurance policies, said:

"Where a party, if his theory of the controversy

is correct, has a good defense at law to 'a purely legal demand' he should be left to that means of defense, as he has no occasion to resort to a court of equity for relief, unless he is preparted to allege and prove some special circumstances to show that he may suffer irreparable injury if he is denied a preventative remedy. Nothing of the kind is to be apprehended in this case, as the contracts, embodied in the policies, are to pay certain definite sums of money, and the record shows that an action at law has been commenced by the insured to recover the amounts, and that the action is now pending in the court whose decree is under re-examination.

"Courts of equity, unquestionably, have jurisdiction of fraud, misrepresentation, and fraudulent suppression of material facts in matters of contract, but where the cause of action is 'a purely legal demand,' and nothing appears to show that the defense at law may not be as perfect and complete as in equity, a suit in equity will not be sustained in a Federal court, as it is clear, that the case, under such circumstances, is controlled by the 16th section of the judiciary act." *Phoenix Mutual Life Ins. Co. v. Bailey,* 13 Wall. 616, at 623, 20 L.Ed. 501, at 503.

In *DiGiovanni v. Camden Fire Ins. Ass'n,* 296 U.S. 64, 68, 56 S.Ct. 1, 3 (1935), a suit to cancel a fire policy on the allegation that the policies were obtained by fraud, the Supreme Court said:

"This Court has recently pointed out that equity will not compel the cancellation and surrender of an insurance policy procured by fraud where the loss had occurred and a suit at law to recover

> the amount of the loss is pending or threatened. *Enelow v. New York Life Insurance Co.,* 293 U.S. 379, 55 S.Ct. 310, 79 L.Ed. 440. The alleged fraud of petitioners, as well as their alleged destruction of the property insured, are defenses available in suits at law upon the policies. While equity may afford relief quia timet by way of cancellation of a document if there is a danger that the defense to an action at law upon it may be lost or prejudiced, no such danger is apparent where, as respondent's bill affirmatively shows, the loss has occurred and suits at law on the policies are imminent, and there is no showing that the defenses cannot be set up and litigated as readily in a suit at law as in equity."

In *Massachusetts Bonding & Ins. Co. v. Anderegg,* 83 F2d 623, 624, (9th Cir.) (1936) on an appeal from the District Court of Oregon, in a suit to rescind an automobile liability policy, this Court said:

> "Generally speaking, a suit in equity to cancel or rescind an insurance policy on the ground of fraud in its procurement cannot be brought after there has been a loss under the policy, since, in such a case, the insurer, by setting up the fraud as a defense when sued on the policy, has ordinarily, an adequate remedy at law."

In *Comer v. World Insurance Co.,* 212 Or. 98, 318 P2d 913, 915 (1957), a suit to cancel a disability policy, the Supreme Court of Oregon, citing *Massachusetts Bonding & Ins. Co. v. Anderegg,* supra, said:

> "In the absence of special circumstances — and none appears in the instance before us —

> equity will not, on charges that the issuance of the policy was induced by fraud, cancel the policy of insurance after loss, particularly when an action on the policy is pending."

In the present case the amended complaint discloses the fact of loss. The policy is made part of the complaint. By its terms the insured must bring his action on the policy within 12 months after loss, and may not bring it until 60 days after proof of loss. (Par. VI, IV, Exh. "A" lines 157-161; 150-156, R. 17). No special circumstances are alleged. No averment is made that a remedy at law is lacking, or that the legal remedy is inadequate.

Appellants never waived their objection to the court's lack of equity jurisdiction and do not now by further argument intend any departure from this position.

II

THE TRIAL COURT COULD NOT ENLARGE ITS JURISDICTION BY TREATING APPELLEE'S AMENDED COMPLAINT AS A PETITION FOR DECLARATORY JUDGMENT.

Directed to Specification of Error Nos. 15, 16

The original complaint in this case was entitled "civil complaint in equity for rescission." The prayer read:

> "WHEREFORE, plaintiff prays for a decree of this Court that defendants be ordered to surrender the said policy of insurance to the plaintiff to be cancelled and that the said policy of insurance be rescinded and held for naught." (R. 3, 4).

This prayer was not changed in appellee's amended complaint (R. 19).

The trial court refused to dismiss appellee's complaint for want of equity but at the trial the court of its own initiative treated appellee's suit as one for declaratory judgment. (Tr. 6). In a similar situation the Supreme Court of Errors of Connecticut held this was error.

In *Aetna Life Ins. Co. v. Richmond,* 139 A. 702 (Conn. 1927), the insurer sued in equity to cancel a life policy after the death of the assured. The defendant demurred to the complaint on the ground that the facts alleged were a complete legal defense to an action on the policy. The demurrer was overrruled and, upon failure to plead further, judgment was entered for the insurer, from which defendant appealed. The Court said:

> "It is quite obvious that the plaintiff sought to state an equitable cause of action, and had not contemplated a proceeding under the Declaratory Judgment Act until the trial court based its decision of the demurrer upon the terms of this legislation, the purpose of which is to declare rights rather than to execute them.

"This complaint in no way suggests that a declaratory judgment is sought. It does not ask the court to declare the rights of the parties. Where such judgment is desired, it should be so stated with precision, in an appropriate prayer for relief whether standing by itself or combined with a prayer for affirmative consequential relief.

"The challenge of the demurrer was not whether the complaint stated valid ground for a declaratory judgment, but whether it was an adequate statement of an equitable cause of action against the defendant. The trial court therefore held the complaint good on a ground not claimed and failed to decide the question which the demurrer presented.

In *Palmer v. Walsh,* 78 F. Supp. 64, 65 (D.C. Ore. 1948), in an action brought by a civil service employee for reinstatement, the District Court of Oregon in an effort to determine what relief plaintiff was seeking, on the question of declaratory judgment said:

"If the instant action be viewed as asking for a declaratory judgment of plaintiff's rights, the court lacks jurisdiction of the cause, since it is undisputed that the Declaratory Judgment Act, 28 U.SC.A. sec. 400, did not enlarge the jurisdiction of the District Courts of the United States. See *Putnam v. Ickes,* 64 App. D.C. 339, 78 F2d 223, at page 226* in which it was said:

'The right of the court to assume jurisdiction

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* Cited by this Court in *Southern Pac. Co. v. McAdoo* 82 F2d 121, 122, (Cir. 9th).

> is to be determined by the principles laid down in the Judicial Code. The Declaratory Act is in no respect amendatory of the Judicial Code either directly or by implication. If Congress had intended by this act to extend the jurisdiction of the courts in cases arising under it, it would have so stated in the act, and in the absence of such statement or language clearly implying such intent, the act must be limited to the jurisdiction expressed therein.' "

It is to be noted in the present case that appellee specifically rejected the court's treatment of its cause as an action for declaratory judgment. At the close of trial, in addressing the Court, counsel for appellee made the following statement:

> "MR. ROBERTS: Your Honor, the plaintiff would join in such a motion, and moves the Court for an order directing a verdict in favor of the plaintiff, and for the Court to enter judgment and decree in this case — *not a declaratory judgment,* but of rescission of the policy that was issued. (Italics ours). (Tr. 251).

Indeed, the whole theory of appellee's case was to negative the existence of a policy — not to seek a declaration of rights under it.

In this case Sec. 267 of the Judicial Code, 28 U.S.C. sec. 384, forbidding equity suits where an adequate legal remedy exists, is controlling.

It may be further noted that the relief given appellee

was equitable and followed the language of its prayer. (Supra, p 29). The court's order reads:

> "IT IS ORDERED AND ADJUDGED that the policy of insurance no. F78185, issued by plaintiff to defendants be, and the same is hereby, cancelled, rescinded and held for naught; and that defendants' counterclaim be, and the same is hereby, dismissed with prejudice." (Judgment, R. 69).

III

DID THE METHOD OF TRIAL DEPRIVE APPELLANTS OF THEIR CONSTITUTIONAL RIGHT TO TRIAL BY JURY.

Directed to Specification of Error Nos. 5, 6, 7, 9, 13, 14a

In denying appellants' motions for new trial and for judgment notwithstanding verdict, the court said:

> "Since defendants insisted on a jury trial and were notified by the court some months prior to the trial that the issues of fact would be submitted to a jury, they are not now in a position to complain of the court's action in treating the proceeding as an action at law for a declaratory judgment and in submitting the issues of fact to a jury." (R. 72).

This was February 2, 1965, almost two months after trial.

However as late as August 11, 1964, the court said:

> "I will stay with my previous rulings on the jurisdictional phase * * * without prejudice to

> renew the motions on the jurisdictional questions at the close of the plaintiff's case."

At that time the court ordered the parties to file a pretrial order and also ordered defendants to present their counterclaim. (Order, R. 49).

The pre-trial order was lodged September 29, 1964, and filed on the day of trial, December 14, 1964. (R. 90). In the pre-trial order appellants contended they

> "may not be compelled to file a counterclaim * * because plaintiff has no claim in equity which this court may entertain and because there is a prior action at law pending * * before the * * District Court * * of Nevada." (Par. VIII, R. 58)

Appellants also demanded a separate and prior trial by jury on the counterclaim required to be presented. No reply to this counterclaim was made by appellee. (Pretrial order "9", "10", R. 59).

On October 1, 1964, the court, by letter, advised counsel for the respective parties that the court "was giving serious consideration to submitting to a jury all of the issues of fact in this case." (Designation of Record, "16", R. 78).

Appellants respectfully submit that to the moment of trial they believed, as they had the right to believe, that the court would either (1) try appellee's equity

suit with an advisory jury or if indeed the counterclaim had been "filed", would (2) proceed under Rule 42(b) to try the counterclaim with a common law jury.

> "Rule 42(b) specifically gives the power to the court to prevent 'prejudice' such as that to the plaintiff's right to trial by jury by 'order(ing) a separate trial of any claim' here by ordering first a separate common law trial by jury on the issue of damages, in which the issue of infringement and the amount of damages will be determined before the issue on the equitable issues."

Bruckman v. Hollzer, 152 F2d 731, 732 (9th Cir. 1946)

Beacon Theatres, Inc. v. Westover, 79 S.Ct. 948, 955; 359 U.S. 500, 508

Appellants could not foresee that the court would impanel a special jury in a declaratory judgment action and submit to such a jury issues which could be tried only in an action on the policy. No such jury was demanded and under the circumstances of this case no such jury could have been demanded. Appellants respectfully submit that the verdict in this case cannot be regarded as binding on the court.

FRCP 39(c)

(*American*) *Lumbermens Mut. Cas. Co. v. Timms & Howard,* 108 F2d 498 (2nd Cir. 1939)

Compare *Palmiero v. Spada Distributing Co.,* 217 F2d 561 (1954): Spada initiated the litigation by a suit in equity. All the equitable issues having passed out of the case prior to trial, the court tried it as an action at law, reversing the order of the parties. Then, of its own motion, the court submitted the cause to the jury on special interrogatories and failing to submit all the issues made findings of fact after the jury was dismissed.

The Ninth Circuit Court held that Palmiero was prejudiced by the trial court's failure to take a general verdict, and held that a new trial was required to do justice between the parties.

It is to be noted that in the present case counsel for appellee did request that the issues be submitted to the jury on special interrogatory:

> "MR. ROBERTS: Your Honor, I realized when we submitted instructions that the Court would have some problems. As I read the defendants' instructions and also my own, the only thing I would inquire of the Court is whether the Court would submit to the jury a special interrogatory rather than a verdict form.
>
> "THE COURT: If we get into interrogatories we are getting into what issue is this and what issue is that, and we will have all the little side issues involved. So I am submitting a form of verdict that if they find one way their verdict will be for the plaintiff * * *." (Tr. 253, 254).

Earlier the Court had said:

> "I am not going to definitely give an instruction on the question of what is or what is not an estoppel, because I believe that amounts to an estoppel in itself if these were the facts." (R. 252)

No such instruction was given. Appellants respectfully submit it was error for the court to refuse to give appellants' requested instruction on estoppel, No. 4, (Supra, p 19, 30).

As related to this question and as separate from the question of venue appellants respectfully submit that by trying this cause as one in equity their rights have been substantially prejudiced in the following respects:

(a) The control of forum by appellee.

Mutual Life Ins. Co. v. Marzec, 262 NYS 558

Crosley Corp. v. Westinghouse Elec. & Mfg. Co., 43 F. Supp. 690

(b) The inversion of the parties in the trial of the action.

(c) The loss of attorney's fees as provided by ORS 736.325 in the trial court and on appeal should appellants ultimately prevail.

Assuming arguendo that the court otherwise had jurisdiction to try appellee's suit as a declaratory

judgment action, appellants respectfully submit that it was error to entertain the action because appellee was really trying out the validity of a defense which should have been determined in the action at law. Further, had the action determined the status of Roger Chaney, it would in no event have been "destructive" of appellee's case.

> *Aetna Casualty & Surety Co. v. Quarles*, 92 F2d 321 (4th Cir. 1937)
>
> *Fireman's Fund Ins. Co. v. Hanley*, 140 F.Supp 206, 213 (1956)
>
> *Employers Mutual Liab. Ins. v. Bluhm*, 227 Ore. 415, 362 P2d 755 (1961)

Venue:

> Tr. 81
>
> *Commonwealth v. Rutherfoord*, 169 S.E. 909, 90 ALR 348
>
> *McGrath v. Zander*, 179 F2d 649 (Dist. Col. 1949)

IV

UNDER THE STATUTORY LAW OF OREGON ROGER CHANEY COULD NOT ACT AS AN INSURANCE BROKER.

Directed to Specification of Error Nos. 19, 23, 36, 39

> "* * the insurance laws of this state are for the protection of the insurance buying public. Such

> laws shall be liberally construed and shall be administered and enforced by the Insurance Commissioner to give effect to this policy."
>
> Proposed Preamble to Insurance Code, Report of Legislative Interim Committee on Insurance, January 1965.

A resume of Oregon's insurance law makes impossible any conclusion except that every person licensed under the General Insurance Law in the State of Oregon must be regarded as the agent of the insurance company and not the agent of the insured in all matters relating to insurance.

The original insurance act was passed in 1887. In the Laws of Oregon, 1887, p. 124, section 19, "broker" was defined as:

> "* * any person who solicits insurance, receives an application or order to write, renew or procure any policy, or collect any premium, or who attempts as middleman to place any fire insurance in this state *when such person holds no authority as agent from any insurance company or general agent of such company,* shall be deemed an insurance broker * * *" (Italics ours).

"Agent" was first defined in the Laws of 1899, p. 187, 188 as:

> "* * *any person who solicits insurance, receives an application or order to write, renew or pro-

> cure any policy or collect any premium, or who attempts as middleman to place any fire insurance in this state, shall be deemed an insurance agent * * *."

The present insurance code was enacted in 1917. That act, Chap. 203, p. 312, repealed Section 4665, Lord's Oregon Laws, the section then defining "broker." The section defining "agent" remained.

In 1923, Chap. 79, p. 109, an act "to provide for the licensing of nonresident brokers of insurance in the state of Oregon" was passed. That act now appears as part of Chapter 750 of the Oregon Revised Statutes.

In 1943, by Chapter 445, p. 668, "agent" was redefined and "solicitor" was for the first time separately defined. For the first time provision was made for the examination of both. (p. 673). These definitions and provisions appear in the present insurance law, entitled "Insurance Law Generally" and is contained in Title 56, Chapter 736 of the Oregon Revised Statutes.

> ORS 736.005(e) defines "Insurance agent" or "agent" as "a person authorized in writing by any insurance company lawfully authorized to transact business in this state to act as its representative, with authority to solicit, negotiate and effect contracts of insurance in its behalf * *."

> ORS 736.005(f) defines "Insurance solicitor" or

"solicitor" as "an individual authorized by a duly licensed insurance agent to solicit contracts of insurance solely on behalf of such agent.

ORS 736.410(1) provides that "Every person * * licensed as an insurance agent * * may employ * solicitors. *"

ORS 736.425(1) provides that "No license shall be issued * to any person except an insurance agent or insurance solicitor as defined in ORS 736.005."

Chapter 736, the General Insurance law of Oregon, *contains no provision for the licensing of brokers.*

Chapter 750 of the Oregon Revised Statute contains the law regarding nonresident brokers.

ORS 750.220 provides that "No person shall *in this state* act as an insurance broker, unless such person is a regularly qualified and licensed broker or agent of another state, and until such person has first obtained a license from the State Insurance Commissioner * *." (Italics ours)

ORS 750.210 defines a nonresident insurance broker as "any person *not a resident of this state* * * * who, for compensation, acts, or aids in any manner in negotiating contracts of insurance * * or placing risks, or effecting insurance * * for a party other than himself." (Italics ours)

ORS 750.230(1) requires that "the application * shall state that the applicant intends to hold himself out and carry on business in good faith as an insurance broker, * *", and

> ORS 750.270(1) provides for the revocation of the broker's license, if the licensee "is not holding himself out and actually carrying on business as an insurance broker" * * whereupon
>
> (3) "The commissioner shall publish a notice of the revocation of a broker's license in such manner as he deems proper for the protection of the public." Compare with ORS 736.470 which provides that on the revocation or suspension of any agent's or solicitor's license, the commissioner "shall file a a copy of this order in his office and mail a copy to the party holding said license, or to the party applying for the issuance of a license, at the address given in the application."

Appellant's research has failed to disclose any Oregon case construing these sections of the insurance law on "brokers".

The following is an Opinion of the Attorney-General 1922-1924, p. 414, 415, interpreting Chapter 79, Laws of 1923, the original law regarding nonresident brokers:

> "There is a marked distinction between an insurance agent who represents and acts for a particular company, and a mere broker who is not employed by any specific company but whose business is to procure insurance for such persons as apply to him for that service.
>
> "It is a familiar rule of construction that when a statute uses a term which has a well-known meaning at common law, or where the term used in a statute has acquired a settled meaning through judicial interpretation, it will be presum-

ed, that such term was so used in the statute, in the sense in which it was understood at common law, or as judicially construed, unless by qualifying or explanatory addition the contrary intention of the Legislature is made clear. 25 R.C.L. 292 et seq.

"The question then arises: Is there anything in the statutory definition of a nonresident insurance broker contained in chapter 79 which evinces an intention on the part of the Legislature to change the settled meaning of the work 'broker' and to use the term in a sense radically different from which it is generally understood by the courts?

"The answer to this question must be in the negative."

"From a careful analysis of the entire statute and a comparison of the same with the other insurance laws of Oregon, I conclude that it was not the intention of the Legislature, when defining a nonresident broker, to ignore the distriction between regular agent of an insurance company and a broker.

In *Strangio v. Consolidated Indemnity & Ins. Co.*, 66 F2d 330, 334 (1933), the Nnith Circuit Court had before it the question of whether a clerk for the Southern Pacific Company who had been sending in applications to an insurance company for several years was the agent of the insured or the insurer. At the time of submitting the application in question, Matthias was not licensed. In California the Political Code (Section 633a) did define insurance brokers.

Under the facts of that case, the Ninth Circuit Court held that Matthias was "simply an insurance broker."

> "And, being a broker, he was, under the general law, the agent, not of the insurance company, but of the insured."

> "Again, in Cooley's Briefs on Insurance (2nd Ed.) vol. 5, pp. 4065, 4066, we find the following language: 'Generally, the question as to whether a person through whose aid a policy is procured is the agent of the insurer or the insured is raised with reference to insurance brokers. By the weight of authority, a broker who merely solicits applications, and afterwards places the insurance with such companies as he can induce to take the risk, is regarded as the agent of the insured, * * *."

> "Conceding that notice to a duly authorized agent of the insurer would be sufficient, notice to one who is the agent of the insured, or *whose only relation to the insurer is that of broker,* is not notice to the insurer.' Cooley, supra, vol. 7, p. 6083." (Italics ours)

Finally, the Court said (p. 336):

> "This cause is not governed by the law which makes the insurer liable where the local agent was authorized to and did make an oral contract of insurance. Here, as we have seen, Matthias was a mere broker of the insured, *and in no sense the agent of the insurer.*" (Italics ours)

V

THE COURT ERRED IN OVERRULING APPELLANTS' CONTENTION THAT THE ONLY DEFENSE AVAILABLE TO APPELLEE WAS ITS ASSERTED AVERMENT THAT APPELLANTS FAILED TO DISCLOSE PRIOR LOSS

Directed to Specification of Error Nos. 2, 11

Appellants contended that:

> "Plaintiff is estopped from relying on any asserted allegation or defense except its asserted allegation that defendants failed to disclose to plaintiff that the property had been damaged by fire prior to the issuance of the policy." (Pretrial Order, Par. V, R. 57)

At some time prior to April 2, 1963 appellee had taken statements from its agent, Larry Nelson, and its solicitor, Roger Chaney, and had interviewed appellants. (Tr. 55, 80, 242). Thereafter by letter dated April 2, 1963, appellee stated the following as its reason for denying liability:

> "As you know, without any disclosure to the Company, the property for which coverage was requested had been damaged by fire prior to the time the application for insurance was made or any policy issued. Therefore, under the circumstances, such policy is void and of no force and effect and is rescinded as of its inception date." Pl's Exh. No. 56)

Having knowledge of all the facts and declaring its reason for refusing to pay on a stated ground appellee waived every other ground of objection.

Santino v. Great American Ins. Co. of N.Y. (Nev.) 9 P2d 1000, 1004

Travelers Ins. Co. v. Peerless Ins. Co., (Or. 9th Cir.) 287 F2d 742

Appellee's original complaint, first stating that the policy of insurance was requested on January 17, 1963, "and that pursuant to the request, the said policy was backdated to the 12th of January, 1963," alleged:

> "That the defendants did not disclose to the plaintiff at the time the policy of insurance was requested on the 17th day of January, 1963, that the said * dwelling had already been * damaged by fire on the 15th day of January, 1963 * * (Par. VII, R. 2)

The same allegation appears in appellee's amended complaint. (R. 17). There also appears in the amended complaint as a fifth cause of action an allegation not earlier made which states:

> "That the defendants requested *Roger Chaney* to procure insurance on the property * *; that the said Roger Chaney, at the time * he made application to the plaintiff insurance company for coverage, had knowledge that the * property had been damaged by fire, which fact was not made known to the plaintiff at the time the said application of January 17, 1963 was made." (Par. II, R. 19). (Italics ours)

In the pretrial order appellee for the first time contends:

> "That one Roger Chaney *acted as a broker and agent* for defendants in procuring insurance on the aforesaid property. That the said Roger Chaney at the time of making application to the plaintiff for coverage had knowledge that the said property had been damaged by fire and did not disclose said fact to plaintiff at the time said application for insurance was made." (Par. XII, R. 56). (Italics ours)

Finally, at the time of trial appellee amended the pretrial order by adding to paragraph XII, supra, the words "willfully concealed" after the words "had been damaged by fire and."

This, then, is how appellee developed the theory of its case. What was initially an allegation of fraud by the appellants in the procurement of the policy becomes the fraud of Roger Chaney. But even if fraud can be imputed to Roger Chaney it avails the company nothing because Roger Chaney is its agent and it would be estopped to defend on that ground. Therefore Roger Chaney must be abandoned. But neither the law nor the facts allow this. Appellee at trial therefore urges an issue not made by the pleadings — that Roger Chaney's authority to write insurance on October 30 or 31, 1962, was limited. (It is to be noted that appellee's allegation is that Roger Chaney acted for the Arleys on January 17, 1963.

There is no allegation that Roger Chaney acted for the Arleys in October). Chaney's authority to write the Arleys' insurance was limited, appellee says, because on that day neither Larry Nelson nor Roger Chaney had a Nevada nonresident's license.

VI

THE APPELLEE WAS ESTOPPED TO DENY THAT AUTHORITY OF ITS AGENTS, OR THE VALIDITY OF ITS POLICY.

Directed to Specification of Error Nos. 10, 16-20, 22, 24-28, 29a-32, 34, 35, 37-39

The fact is that Roger Chaney's authority was not limited. He had previously written insurance on the Nevada properties and when he wrote those policies he had no Nevada license. (Tr. 114-116). As to the authority of the Larry Nelson Agency to write the business Mr. Chaney himself testified:

> "I knew we could write the business or have it written *but not having a license we couldn't share in the commission*" (Tr. 70). (Italics ours)

Nothing in the Oregon law prohibits an agent licensed in Oregon from writing insurance on properties outside the state. Nothing in Larry Nelson's agency agreement with United Pacific prohibits him *or the solicitors for which the agreement provides* from writing insurance on property outside the state. (Pl's Exh. No. 11)

The law of Nevada does require that all policies on property in that state shall be countersigned by a resident agent and it does provide that commissions may be paid only to nonresident agents licensed undér its laws.

> NRS 684.330:
>
> 1. A company may pay money or commission for or on account of the solicitation or negotiation in this state, or elsewhere, of contracts of insurance * * on property or risks in this state only to its agent, nonresident agent, broker, or nonresident broker, duly licensed under this Title * * *"
>
> NRS 684.350: "Countersignature of policies.
> 1. All policies of insurance * * on any property * * located * * within this state, shall be countersigned by a resident agent licensed under this Title to represent the insurer * * *.
>
> 3. Where a contract of insurance covering property * * within this state is negotiated by a licensed nonresident agent or broker outside this state, *or by a company which is not represented by a licensed nonresident agent or broker,* every such policy of insurance * * * shall be countersigned by a resident agent who is compensated on a commission basis * * *" (Italics ours)

The fact is that United Pacific *did write the policy.* And when it wrote the policy it knew neither Chaney nor Nelson had a nonresident license. (Pl's. Exh. No. 8, R. 155, 156). Mr. John Gordon, office manager for United Pacific so testified (Tr. 156):

Q. Did Mr. Nelson say whether or not he had renewed the Nevada license?

A. No, he said that he hadn't renewed. Actually, it would be renewed through us. I mean we would normally be the ones to start the wheels in motion to renew it.

Q. Did you at that time know when his license had expired?

A. Yes.

Q. When had it expired?

A. It expired on — let's see — April 30, 1962.

Q. Did you subsequently renew it?

A. Yes, only — it was renewed effective, I believe, May 1st, 1963.

In *Hahn v. Guardian Assurance Co.,* 32 Pac. 683 (Or. 1893), prior to statutes defining the authority of agents (supra p. 17), the insurer sought to defend on a similar ground. An agent had solicited insurance on property in Washington. After loss the insurer denied liability on the ground the agent was a special agent with limited powers, and with no authority to write insurance outside of Multnomah County, Oregon.

"The testimony for the plaintiff shows that Ackerman represented himself to be the agent of defendant, and solicited the insurance of plaintiff's property; that he negotiated the insurance of his property in the State of Washington with

Ackerman, and with no other person; that he left the matter of the insurance wholly with Acker-, man, and left for New York, supposing that he had full authority to act as agent for the company in the state of Washington, and without knowledge or information of any limitation on his powers; that he received the policy from Ackerman, and paid him the premium for it. Upon the part of the defendant, the record discloses that it accepted the risk, issued the policy, received the premium without objection and treated the policy as valid until after the fire. Upon this state of the case the plaintiff contends that the defendant, by its conduct, held Ackerman out as its duly accredited agent, and he was justified in assuming that he had full authority to effect the insurance. The defendant, by its testimony, sought to limit the authority of Ackerman to that of a local agent, whose jurisdiction was confined to Multnomah County, and consequently that he had no authority to write policies or to take risks on buildings in the state of Washington, nor to speak for or bind the company in relation to any risk outside the territory."

The Supreme Court of Oregon held: (p. 684)

"The acts of an agent performed within the scope of his real or apparent authority are binding upon his principal. It is enough if, under all the circumstances, he had apparent authority in the matter, although in fact his authority was limited."

Hardwick v. State Ins. Co., (1891) 20 Or 547, 26 Pac 840, 844

Union Ins. Co. v. Wilkinson, 13 Wall. 22, 20 L.Ed. 617

Hahn v. Guardian Assurance Co., 32 P. 683, supra, is reported in 23 Or. 576. A footnote refers to *Phoenix Assurance Co. v. Wachter,* (Pa.) 19 Atl. 289. The following is quoted at page 290:

> " 'The general rule that a principal is responsible for the misrepresentations of his agent, within his authority is beyond question; and the better opinion is that, as to third parties affected by his acts or words, it is the apparent scope of his authority, and not his actual instructions, that must govern. That is the basis on which the business of the world, in the present day, is transacted; and the rule should be enforced, in a liberal spirit, with regard to the actual habits of the community.' * * * 'It would be disastrous to commercial as well as other interests if a person, by acting through the agency of another, could shield himself from liability for such person's acts *ad libitum.* Fortunately, no such rule exists; and he who entrusts authority to another, in whatever department of business, is bound by all that is done by his agent within the scope of his apparent power, and cannot screen himself from the consequences thereof upon the ground that no authority in fact was given him to do the particular act, unless the act was clearly in excess of his apparent authority, or was done under such circumstances as to put him upon inquiry as to the agent's real authority.
>
> "Perhaps it may be said that, while the evidence referred to tends to create an estoppel, the question of Spofford's real or apparent agency in the premises, etc., should have been submitted to the jury under proper instructions. That would be so, if there was any conflict of testmony, but

> there is none. All the essential facts are clearly and conclusively established by uncontroverted evidence, part of which was introduced by the company itself. When the facts are admitted, or established beyond all controversy, as they are in this case, there is no necessity for submission to a jury. It then becomes the province of the court to declare the law applicable to such facts. That was done in this case; and, for reasons above suggested, we think there is nothing in the record that calls for the reversal of the judgment."

Universal Ins. Co. v. Kruse, 306 F2d 661 (9th Cir. 1962)

Appellee also urged (supra p. 19) that Roger Chaney made some inquiries as to how the insurance might be written (Tr. 70). It is equally clear that Mr. Nelson — if such inquiries were made — had knowledge of them (Tr. 15). The record is clear that the Arleys dealt with Mr. Chaney only as an agent or solicitor in association with Larry Nelson and not as a *broker*. (D's Exh. Nos. 51, 52, 57, 68, 75).

MFA Mutual Ins. Co. v. Jackson, 271 F2180 (8th Cir. 1959)

In *Mock V. Glen Falls Indem. Co.*, 210 Or. 71, 309 P2d 180, (1957) the company refused to extend coverage under an automobile liability policy. The agent told Mock he would get such coverage for him — that he would get or write a different policy, but that meanwhile he would continue to be covered.

"Pratt attempted to get driveaway coverage from Lloyds of London, but he felt the premium was too high, and he finally concluded to write a comprehensive liability policy with Glen Falls."

No attempt was made in *Mock* to hold that its agent had "acted" as a broker.

In an early and leading case, another insurer urged that a soliciting agent was not an agent of the company but a mere broker because the policy contained a provision that no one except a person authorized in writing shall be considered the agent of the company. In that case Strecker was employed to solicit business exclusively for the insurer's agent, Van Alsyne. The court said:

> Mr. Van Alsyne whose firm employed the solicitor "denominated this kind of service as the service of a broker, and he also stated that Mr. Strecker was at liberty to work for any other insurance company if he pleased. *If he meant that Mr. Strecker had the power to violate his agreement with them, and instead of working exclusively for them, work for others, why that is self-evident proposition, and has no bearing upon the question as to the capacity in which he was employed by them.* If he meant to assert that he was not exclusively employed by them, then it is a contradiction of what the witness has already several times stated to be the truth, and the fact of exclusive employment, if material, should have been left to the jury to determine." (Italics ours)

The question of Mr. Chaney's employment is governed by statute (supra p. 39, 40)

On the final ground urged — that Roger Chaney had wilfully failed to disclose to United Pacific that the property was already damaged when he ordered the policy — the record is clear that Larry Nelson, the duly authorized agent for United Pacific, knew on the day of the loss, and on all the days that followed to the time he sent his statement and the policy to appellants that the property was damaged. (Tr. 15, P's Exhs. 11). The record is clear that Porter James Courtney, staff adjuster at United Pacific Insurance company, knew. And the record is clear that Roger Chaney, licensed solicitor for United Pacific knew. While appellants are not required to know and are not charged with knowing "the insurance business, and the relationships between the insurance companies, insurance brokers, and insurance agents (*Universal Ins. Co. v. Kruse*, 306 P2d 661, supra, p. 52) appellants respectfully suggest that Roger Chaney was doing on January 17, 1963 what he should have done in October or November of 1962. (R. 143).

Appellee's creation of a separate "United Pacific" from whom Roger Chaney could (1) conceal the fact of damage or from whom Roger Chaney in the place and stead of appellants could (2) order a policy, falls in light of ORS 736.475, which provides that

> "No foreign or alien company authorized to transact insurance * * in this state shall make, write, place or cause to be made, written or placed,

> any policy * * except through its regularly commissioned and licensed resident insurance agents * *",

in this case, Larry Nelson.

Appellants respectfully submit (1) that having issued its policy appellee was estopped as a matter of law from denying the authority of its agent, (2) that the issue of Chaney's authority was outside the scope of the pleadings, but having been introduced, the trial court erred in not submitting this issue to the jury.

VII
THE TRIAL COURT ERRED IN INSTRUCTING THE JURY THAT IF CHANEY DID NOT NAME THE COMPANY THEY MUST FIND FOR THE APPELLEE.

Directed to Specification of Error Nos. 33, 38

If in the trial of appellee's suit to rescind its policy, it was necessary for appellants to prove the elements of an oral contract, the court's instruction was nonetheless improper because on the undisputed facts in this case there was but one company in which Larry Nelson could write Nevada coverage — and that company was United Pacific. Roger Chaney testified:

> Q. Now was it a fact that in all of this period of time, that is to say, from October of 1962 until March of 1963, in that general period of time, the United Pacific Insurance Company was the only company that was licensed to write fire

insurance under the laws of Oregon as well as under the laws of Nevada.

A. In our office that is true.

Q. In your office, that is, you couldn't have written it with any other company except United Pacific?

A. That is true.

Q. That was true in October of 1962 as well as it was in January and later?

A. Yes, as far as our office goes (Tr. 97, 98).

Western National Ins. Co. v. LeClare, 163 F2d 337 (9th Cir. 1946)

Croft v. Hanover Fire Ins. Co., 21 S.E. 854

CONCLUSION

Appellants respectfully submit that (1) the trial court had no jurisdiction in this case and appellee's suit should have been dismissed. (2) The method of trial substantially prejudiced appellants' rights and deprived them of their constitutional right to trial by jury.

Appellants are entitled to judgment on the pleadings and on the uncontradicted evidence as a matter of law because the policy issued by appellee was procured through its duly authorized agent and evidenced the agreement made by the parties.

Appellants therefore respectfully request one of the following three alternatives:

1. That the judgment of the lower court be reversed with directions to dismiss appellee's suit.

2. That the judgment of the lower court be reversed with directions to enter judgment for appellants.

3. That the judgment of the lower court be reversed with directions for a new trial.

Respectfully submitted,
CHARLOTTE HUNTER ARLEY
Attorney for Appellants

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CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

DATED this 27th day of August, 1965.

CHARLOTTE HUNTER ARLEY

Attorney for Appellants

No. 20095

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Peter M. Elliott, as Trustee in Bankruptcy of the Estate of Van's Market, a co-partnership composed of Kenneth M. Price and William R. Babineau, Bankrupt,

Appellant,

vs.

A. J. Bumb, as Trustee in Bankruptcy of the Estate of Security Currency Services, Ltd., Bankrupt,

and

Corporations Commissioner for the State of California,

Appellees.

APPELLANT'S OPENING BRIEF.

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No. 20095

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PETER M. ELLIOTT, as Trustee in Bankruptcy of the Estate of VAN'S MARKET, a co-partnership composed of KENNETH M. PRICE and WILLIAM R. BABINEAU, Bankrupt,

Appellant,

vs.

A. J. BUMB, as Trustee in Bankruptcy of the Estate of SECURITY CURRENCY SERVICES, LTD., Bankrupt,

and

CORPORATIONS COMMISSIONER FOR THE STATE OF CALIFORNIA,

Appellees.

APPELLANT'S OPENING BRIEF.

This is an appeal from an order of Judge Thurmond Clarke, United States District Judge for the Southern District of California, made and entered on April 9, 1965, in which he reversed, on review, an order of Referee Robert B. Powell, made and entered on January 6, 1965, which adjudged and decreed any trust created in favor of Security Currency Services, Ltd., pursuant to Sections 12300.3 and 12300.4 of the Financial Code of the State of California, to be wholly invalid against the trustee in bankruptcy of Van's Market, pursuant to Section 67(c)(2) of the Bankruptcy Act. (11 U.S.C.A. Sec. 107 (c)(2)).

I.

JURISDICTIONAL STATEMENTS.

On November 19, 1963, an involuntary petition in bankruptcy was filed against Van's Market *et al.* in the United States District Court for the Southern District of California, Central Division, and thereafter, on March 5, 1964, Van's Market, a copartnership composed of Kenneth M. Price and William R. Babineau was adjudged a bankrupt.

Pursuant to an Application by Peter M. Elliott, as trustee in bankruptcy of Van's Market, etc. [R-2], an Order to Show Cause was issued by the Referee on September 18, 1964 [R-5], and Answers were filed by A. J. Bumb, as trustee in Bankruptcy for the estate of Security Currency Services, Ltd., bankrupt, and the California Corporations Commissioner [R-81 and 84].

No oral or documentary evidence was introduced but the matter was submitted to the Referee pursuant to a written Stipulation of Facts, filed November 20, 1964 [R-109].

The Referee issued his Memorandum Opinion on December 16, 1964 [R-112], and Findings of Fact, Conclusions of Law and an Order were entered by the Referee on January 6, 1965 [R-119 and 123].

Both A. J. Bumb, as trustee for the estate of Security Currency Services, Ltd., bankrupt, as well as the California Corporations Commissioner filed petitions for review [R-7 and 16], and the Referee issued his Certificate on Review [R-26].

Hearing on review was had before the Honorable Thurmond Clarke, United States District Judge, on March 29, 1965, at which time argument was had and the matter was submitted.

On April 9, 1965, Judge Clarke entered his Order [R-79], reversing the aforesaid Order of the Referee.

Within the time allowed by law, your appellant filed a Notice of Appeal, to wit, on April 19, 1965 [R-125], and your appellant has taken the steps required by law in presenting the necessary record on the within appeal.

The jurisdiction of the Court of Appeals is invoked pursuant to Section 24 of the Bankruptcy Act (11 U.S.C.A. Sec. 47).

II.
STATEMENT OF FACTS.

The facts pertaining to the within appeal are not in dispute and, in fact, the same have been stipulated to by all parties.

An involuntary petition in bankruptcy was filed against Van's Market etc., on November 19, 1963, and thereafter, Van's Market, a copartnership composed of Kenneth M. Price and William R. Babineau, was adjudged a bankrupt on March 5, 1964. Peter M. Elliott is the duly appointed, qualified and acting trustee in bankruptcy of said Van's Market.

On October 15, 1963, Van's Market executed a general assignment for the benefit of its creditors to the Credit Managers Association of Southern California, a California corporation, and as of that date ceased to do business. Van's Market was an agent of Security Currency Services, Ltd., for the purpose of selling money orders and checks.

For the period preceding October 15, 1963, there was due from Van's Market to Security Currency Services, Ltd., the sum of $3,092.99, representing proceeds from

the sale of money orders and checks sold by Van's Market as agent for Security, and the additional sum of $16.17, reresenting fees for the sale of checks, making a total obligation due from Van's Market to Security in the sum of $3,109.16. Security honored and paid all checks or money orders from which the above proceeds arose.

Security Currency Services, Ltd. filed a petition under the terms of Chapter XI of the Bankruptcy Act on January 16, 1964, and appellee, A. J. Bumb, was appointed receiver therein. Security was later adjudged a bankrupt and said A. J. Bumb is now the duly appointed, qualified and acting trustee of the estate of Security Currency Services, Ltd., bankrupt, In Bankruptcy No. 166,114-TC in the United States District Court, Southern District of California, Central Division.

The Credit Managers Association of Southern California is presently holding the sum of $2,014.99, which represents monies which were on deposit in Van's Market's bank account prior to October 15, 1963, at Bank of America, Harbor and Palm Branch, Los Angeles, California, and which represented money orders sold by Van's Market for Security.

The difference between the aforesaid sum of $3,109.16 and the aforementioned sum of $2,014.99 or $1,094.17 was commingled by Van's Market with its other assets which were liquidated by the Credit Managers Association of Southern California, as the assignee for benefit of creditors, and the liquidation proceeds in the sum of $2,987.56 were turned over to appellant.

The California Corporations Commissioner asserts no claim to the funds held by appellant nor to the funds

held by the aforesaid Credit Managers Association but is charged with the responsibility of enforcing the Check Seller's and Cashier's Law set forth in Sections 12000, *et seq.* of the California Financial Code.

Similarly, the said Credit Managers Association of Southern California asserts no claim to the $2,014.99 held by it but merely seeks a determination as to who they should pay, either appellant or appellee, A. J. Bumb.

In addition, on or about November 15, 1962, an agreement entitled "Agency Franchise and Trust Agreement" was executed by and between Security Currency Services, Ltd. and Van's Market [Ex. "A"].

III.
SPECIFICATION OF ERRORS.

The Order of the United States District Court, Reversing the Referee's Order [R-79] Is Erroneous in That:

(1) The Court was in error in concluding that, as a matter of law, under the facts of this case, proceeds from the sale of money orders and checks by Van's Market, as agent for Security Currency Services, Ltd., whether,

(a) deposited to a trust account, or

(b) commingled with assets of the bankrupt, constitute trust funds under California Financial Code, Secs. 12300.3 and 12300.4;

(2) The Court was in error in concluding, as a matter of law, that any trust created by Sections 12300.3 and 12300.4 of the California Financial

Code is not subject to the provisions of Section 67(c) of the Bankruptcy Act [11 U.S.C. § 107 (c)];

(3) The Court erred in not finding that there was no express, constructive, or resulting trust;

(4) The Court was in error in not concluding, as a matter of law, that any statutory trust created by California Financial Code Sections 12300.3 and 12300.4 should be treated the same as a statutory lien so far as bankruptcy is concerned;

(5) The Court was in error in not concluding, as a matter of law, that any such trust so created, is merely a state created priority and invalid pursuant to Section 64(a)(5) of the Bankruptcy Act;

(6) The Court was in error in reversing the order of the Referee of January 6, 1965.

IV.

SUMMARY OF ARGUMENT.

(A) Although the Bankruptcy Act Nowhere Deals Explicitly With Statutory Trusts, They Should be Treated the Same as Their Functional Equivalent, the Statutory Lien;

(1) Statutory Trusts Should be Treated the Same as Statutory Liens, so Far as Bankruptcy is Concerned;

(2) The Bankruptcy Act Voids, as Against the Trustee, Statutory Liens on Personal Property not Accompanied by Possession, Levy, Sequestration, or Distraint of Such Property;

(B) The Interest Created by Sections 12300.3 and 12300.4 of the California Financial Code is a State Created Priority, Invalid Under the Chandler Act [Title 11 U.S.C. §104(a)(5)];

(C) The Evidence Does Not Support Any Finding of an Express, Constructive or Resulting Trust;

(D) Even if the Interest Created by Financial Code Sections 12300.3 and 12300.4 Is Not Treated as a Lien, Beneficiaries of a Trust, Whether Statutory or Otherwise, Must Trace the Trust Res, Which Appellees Have Failed to Do.

V.

ARGUMENT.

Introduction.

The instant appeal asks for this Honorable Court to interpret, for the first time, the effect of bankruptcy on any interest created by California Financial Code, Sections 12300.3 and 12300.4 and to also hold for the first time that statutory trusts should be treated the same as statutory liens, so far as bankruptcy is concerned.

At the last session of the California Legislature, a bill was introduced for the repeal of these sections, however, the bill never got out of committee.

A great majority of the "agents" described in the said sections are retail merchants, *i.e.,* retail food markets, the general creditors of which had been favored under the California law, pursuant to Section 3440.1 of the California Civil Code, prior to the enactment of the sections of the Financial Code. The sections seek to

remove assets from the reach of unsecured creditors by stating that a "trust" is created to the extent of the value of money orders sold by the agent, even if the proceeds are "commingled". Presumably then, if an agent sells money orders, and the proceeds are later, for any reason, not in a trust account or even missing, the appellees take the position that a trust is created under the Financial Code on the stock in trade or even the fixtures of the agent to the exclusion of the agent's general creditors.

It is the appellant's position that this creates an interest which operates as a lien upon the physical assets of the agent, and the state legislature, by labeling this interest as a "trust", should not prevent the interest from being subject to the invalidating and subordinating provisions of the Bankruptcy Act.

The appellant also takes the position that the Financial Code sections in question create a priority in favor of one particular class of creditors, *i.e.* licensees under the code, such as Security Currency Services, Ltd. Section 64(a)(5) of the Bankruptcy Act did away with all state created priorities, but one.

It is submitted that if the so-called "trust" is upheld by this Court, the doors would be open to states creating priorities in favor of various classes of creditors, and by labeling such priorities as "trusts" the intent and purpose of Congress in enacting Section 64(a)(5) of the Bankruptcy Act would be defeated. Likewise, the section of the Bankruptcy Act dealing with liens could be circumvented by relabeling all liens created by state laws as trusts.

A. Although the Bankruptcy Act Nowhere Deals Explicitly With Statutory Trusts, They Should Be Treated the Same as Their Functional Equivalent, the Statutory Lien.

(1) Statutory Trusts Should Be Treated the Same as Statutory Liens, so Far as Bankruptcy Is Concerned.

Certainly it cannot be said that any trust created in favor of Security Currency Services, Ltd., pursuant to Section 12300.3 of the California Financial Code is anything other than a statutory trust.

Once that premise is reached, to wit, that any trust created is a statutory trust (and it is submitted that no other conclusion can be reached), then it must be determined what effect the Bankruptcy Act has upon any such statutory trust.

As stated in Volume 4, Collier on Bankruptcy, Section 67.12(2), at page 122:

> "*A statute may create or recognize an interest that is labelled a trust rather than a lien. Such a trust may nevertheless be construed functionally as equivalent to a statutory lien, subject to subordination, restriction and invalidation, in accordance with Section 67(c).* If, however, the statutory trust is analogized to an express, resulting or constructive trust, the beneficiary would be entitled to reclaim the statutory trust res without the subordination imposed by Section 67(c)" (Emphasis added).

As will be noted from the following quotation from Collier on Bankruptcy, the Bankruptcy Act nowhere deals explicitly with the rights of beneficiaries of statutory trusts. It is submitted therefore that we must be

guided by analogies and by interpretations of trusts rendered by the courts. In Volume 4, Collier on Bankruptcy, Section 67.25(a), the author goes on to say:

> "Although statutory trusts are not infrequently encountered, the Bankruptcy Act nowhere deals explicitly with the rights of beneficiaries of such trusts. Such trusts are likely to be created for the protection of the rights of laborers, materialmen, subcontractors, architects, and engineers in the moneys paid or payable to a prime contractor, or of the sovereign in respect to taxes collected or held by its collectors. In *Wickes Boiler Co. v. Godfrey-Keeler Co., Inc.,* the Court of Appeals for the Second Circuit had before it a New York statutory trust fund provision. A contractor, Godfrey-Keeler, filed a petition for an arrangement under Chapter XI. At that time, it owed approximately $1,800 to the Wickes Boiler Co., its subcontractor, and in turn had a balance of $8,800 due it from the Brooklyn Yarn Dye Company. This sum was sufficient to pay all laborers and materialmen. Although the Wickes Boiler Co. had never filed a mechanic's lien, it was held that the $8,800 balance, when received by the debtor-contractor, would become a trust fund for the benefit of creditors within the terms of the New York statute, and that the Wickes Boiler Co. was entitled to have it impressed with a trust to the extent of its claim. The court denied that there was substance to the debtor's claim that the New York statute creates a class of creditors entitled to priority in contravention of §64(a)(5) of the Bankruptcy Act. It stated in its first opinion:

'There has been no attempt to alter the priorities fixed by Section 64 in marshalling the assets of a bankrupt's estate. These priorities apply only to the estate of the bankrupt, and not to trust funds of which third parties are the beneficial owners. The question here is whether the property claimed by the subcontractor is or is not an asset of the debtor's estate'.

But on rehearing the court made this significant comment:

'It is unnecessary to discuss the effect of §67(c) of the Bankruptcy Act upon the distribution of funds in the hands of the trustee inasmuch as it does not appear that the general estate of Godfrey-Keller Co., Inc. had sufficient assets to pay the costs, expenses and wages mentioned in §64(a)(1) and (2) of the Bankruptcy Act. Cf. Note, 50 Yale L. J. 1268 . . . The petition for a rehearing is accordingly granted . . . without prejudice however to the right of the trustee, if he be so advised, to claim in the bankruptcy court that the (balance) due from Brooklyn Yarn Dye Company is subject to any priorities given under §64(a)(1) and (2), if other assets should not be available'.

"It has long been established doctrine that funds held by a bankrupt subject to an express, resulting, or constructive trust are not a part of the bankrupt's estate for distribution among his creditors but belong to the beneficiaries of such trust. The excerpt quoted from the first opinion above seems to indicate that the court was willing to put statutory trusts upon the same basis. This, however,

> would be a mistake, *since the statutory trust is no more than a legislative device to protect a particular class of creditors.* In view of the elimination of all state-created priorities but one in §64(a)(5) and the avowed purpose in §67(c) to implement the policy of §64(a) by striking at statutory liens indistinguishable from priorities, there is reason for treating the statutory trust in the same way as its functional equivalent, the statutory lien, so far as bankruptcy is concerned. The excerpt quoted from the opinion on the rehearing in the Wickes Boiler case indicates a judicial willingness to consider the statutory trust in that perspective" (Emphasis added).

Perhaps it is appropriate here to discuss Volume 4 Collier on Bankruptcy Section 70.25, pages 1210-1212. This is apparently the authority which the District Court relied upon in reversing the Referee, and was also cited to the District Court by appellee, A. J. Bumb, and the cases contained in this section of Collier's were also cited to the District Court by appellee, Corporations Commissioner of the State of California.

The aforesaid passage from Collier states, beginning on page 1210:

> "Statutory enactments may operate to create trusts in favor of designated persons. Recognition of such trusts, together with their incidents, has generally been regarded by the bankruptcy courts as a matter of following and applying the local law. *Matter of Heintzelman Construction Co., Inc.* (WD.N.Y. 1940) 46 Am. B.R. (N.S.) 28, 34 F.Supp. 109. Thus, under the New York Lien Law, funds derived by the trustee of a bankrupt

contractor as the avails of work done by the bankrupt upon property which had been improved in part by labor and materials furnished by certain claimants, or from the sale of property owned by the bankrupt which had been improved by labor and material furnished by such claimants, are impressed with a trust in favor of the claimants. *Albert Pick Co., Inc. v. Travis* (D.C., N.Y.), 25 Am.B.R. (N.S.) 230, 6 F.Supp. 486; *Matter of Heintzelman Construction Co., Inc.* (W.D. N.Y. 1940) 46 Am. B.R. (N.S.) 28, 34 F.Supp. 109; *Wickes Boiler Co., Inc. v. Godfrey-Keeler Co., Inc.* (C.C.A. 2d, 1940) 44 Am.B.R. (N.S.) 530, 116 F.(2d) 842, mod. on rehearing (C.C.A. 2d, 1941) 46 Am.B.R. (N.S.) 217, 121 F. (2d) 415, cert. den. (1941) 314 U.S. 686, 62 S. Ct. 297, 86 L.Ed. 549. A similar trust exists in favor of a claimant for workmen's compensation insurance premiums accruing against the bankrupt in connection with the improvement of the property. *Matter on Heintzelman Construction Co., Inc.,* supra. Likewise, it has been held that sales taxes collected under the local laws of the City of New York by a bankrupt merchant from his customers, while acting as a debtor in possession in a corporate reorganization, are held by him as trustee for and on account of the city and do not become part of his bankrupt estate when the proceedings are later transformed into ordinary bankruptcy. *Matter of E. Goldberger, Inc.* (E.D.N.Y. 1940) 46 Am.B.R. (N.S.) 35, 32 F.Supp. 615. See also *City of New York v. Rassner* (CC.A. 2d, 1942) 49 Am.B.R. (N.S.) 219, 127 F.(2d) 703 (sales tax collected by debtor

in possession pursuant to Chapter XI proceeding afterward superseded by ordinary bankruptcy). In cases where taxes, such as sales or social security taxes, are collected or withheld prior to bankruptcy under a statute making certain persons responsible for the collection or withholding, the relatonship established between the collector and the taxing authority may be either that of a taxpayer or merely that of debtor-creditor, depending upon the collector's obligation to pay over the tax irrespective of collection from others. For discussion, see §64.405, supra, under subhead 'Collector of Taxes.' If a collector is a taxpayer debtor and the taxing authority has no lien, priority of payment in the collector's bankruptcy will be determined under §64a(4); if the collector is merely a debtor (without being also the taxpayer) and the taxing authority has no lien, the United States as a tax claimant is entitled to a fifth priority under §64a(5) while the other taxing authorities are in the class of general unsecured creditors. Ibid.; ¶¶64.501, 64.502, supra. With respect to the treatment of tax liens in bankruptcy, see ¶67.24, supra. See also ¶64.02 supra, under subhead 'Priorities Distinguished from Liens,' and ¶67.20[9], supra. Occasionally, however, a statute may make a tax collector a trustee for sums collected or withheld, as exemplified by §7501 of the Internal Revenue Code on 1954. Formerly Int. Rev. Code §3661. See discussion in ¶64.405, supra, under subhead 'Collector of Taxes;' also *Matter of Frank* (S.D.N.Y. 1939) 39 Am.B.R. (N.S.) 697, 25 F. Supp. 1005; *Hercules Service Parts Corp. v. United*

States (C.A. 6th, 1953) 202 F. (2d) 938; *In re States Motors, Inc.* (E.D. Mich. 1958) 168 F. Supp. 82; *In re Airline-Arista Printing Corp.* (S.D.N.Y. 1957) 156 F. Supp. 403. In *City of Dallas v. Crippen* (C.A. 1948) 171 F. (2d) 526, Circuit Judge Waller dissented from a ruling according priority to a tax lien of the city over the claim of the United States in respect to taxes withheld from the bankrupt's employees. The dissent contended that the withheld taxes were trust funds belonging to the United States, but the majority insisted that the United States had claimed no trust fund. Neither opinion referred to Int. Rev. Code § 3661. *Taxes within Scope of Statutory Trust*—In Matter of *Tele-Tone Radio Corp.* (D.N.J. 1955) 133 F.Supp. 739, the trustee successfully resisted the Government's effort to establish a statutory trust under former §3661 in respect to a deposit by the debtor which was alleged to consist of collections by the debtor and its successor trustee of the federal excise tax imposed on manufacturers by Int. Rev. Code of 1954 § 4061 et seq. The provision for a statutory trust, however, applies only when a 'person is required to collect or withhold'. Here collection of the excise tax was not required and it was found that the tax was not collected as such from the vendees of the debtor. But before the government can recover on a trust basis, it must show that the taxes claimed were actually collected or withheld and must trace such funds according to prevailing rules in trust cases. *Matter of Independent Automobile Forwarding Corp.* (C.C.A. 2d, 1941) 45 Am.B.R. (N.S.) 230, 118 F. (2d) 537,

rev'd on other grounds sub nom. *United States v. State of New York* (1942) 315 U.S. 510, 8 Am.B.R. (N.S.) 85, 62 S. Ct. 712, 86 L.Ed. 998. The court of appeals opinion is quoted in part in ¶ 64.405, supra, under subhead 'Collector of Taxes.' See also *Matter of Frank* (S.D.N.Y. 1939) 39 Am.B.R. (N.S.) 697, 25 F.Supp. 1005; C. J. Waller's dissent in *City of Dallas v. Crippen* (C.A. 5th, 1949) 171 F. (2d) 526, 529, cited in n. 33, supra. But cf. *Hercules Service Parts Corp. v. United States* (C.A. 6th, 1953) 202 F.(2d) 938, *United States v. Sampsell* (C.A. 9th, 1951) 193 F.(2d) 154, and *In re Airline-Arista Printing Corp.* (S.D.N.Y. 1957) 156 F.Supp. 403, all cited in n. 44, infra, where the United States was relieved of the necessity of tracing."

However, let us examine, closely, the cases cited by Collier, *supra,* and which were also cited by the Corporations Commissioner to the District Court.

In the Matter of Heintzelman Construction Company, Inc., the Court held that under the provisions of the *New York Lien Law, which created a trust* in favor of the claimants who supplied labor and materials, and also in favor of a claimant for workmen's compensation insurance premiums, *against funds due to a bankrupt contractor* the trustee in bankruptcy took subject to the trust. The Court stated on page 111:

"The funds from the improvement were a trust fund, and never were a part of the estate. They were such in the hands of the owner. The trustee obtained no equity or interest greater than that of the bankrupt".

However, in reading on, we find the following language on page 112:

> "Rather it seems that each claimant *has a lien* on the moneys now in the hands of the trustee —" (Emphasis added).

And, the Court further states, also on page 112:

> "The Referee has *properly directed the payment of expenses of administration* and application of the balance, after such payment, to the payment of the several priority claims in controversy here —" (Emphasis added).

Although it is not ascertainable from the decision the Court must have based the latter quoted holding upon Section 67(c)(1) of the Bankruptcy Act. Clause (2) of Section 67(c) had not yet been added at the time of the *Heintzelman* case.

In the '*Albert Pick Co.* case, the Court likewise held that a fund in the hands of a trustee in bankruptcy was impressed with a "trust" in favor of subcontractors, materialmen and laborors, pursuant to the New York Lien Law. The Court, in that case, stated:

> "To follow the trustee's contention that the funds should be distributed among all the creditors would nullify the very purpose of the statute, which was to distribute the specific fund to a *preferred class of creditors*. There would be no purpose for the Lien Law were it not that the State intended to protect the very class that the statute outlined. If the contractor attempts to deprive the *lienors* of their rights, the Court should restrain and not help facilitate the avoidance of lawful obligations". (Emphasis Added)

The Court went on to hold that the claimants' rights "as trust creditors to the fund have *priority over the general creditors*" (Emphasis Added).

It is submitted that the decision is not clear whether the claims were allowed as a state created priority or as a lien, but it was allowed as one or the other. If allowed as a priority, of course, the case is no longer of any merit since Section 64(a)(5) of the Bankruptcy Act was enacted in 1938, and does away with state created priorities.

The decision refers to the claimants as "lienors". There is nothing in the decision to controvert a supposition that the claims were subordinated to the expenses of administration, pursuant to Section 67(c)(1) of the Bankruptcy Act, as they were in the *Heintzelman* case.

The *Wickes Boiler Co.* case cited by Collier is discussed *supra*. It is submitted that the *Goldberger* and *Rassner* cases have no application here, in that these cases involve a "trust" created by the collection of New York City sales taxes by a debtor in possession in Chapter XI proceedings, *after* institution of bankruptcy proceedings.

In short then, it is submitted that the aforesaid excerpt from Collier and the cases cited therein, which the District Court apparently relied upon in reversing the Referee (where applicable at all), actually support appellant's position.

If the courts admit that the interests in question are subject to expenses of administration, they are clearly treating the so-called "trusts" as liens and subject to the provisions of Section 67(c) of the Bankruptcy

Act, clause (1) of which subordinates non-possessory liens on personal property to the payment of expenses of administration and prior wage claims.

(2) The Bankruptcy Act Voids, as Against the Trustee, Statutory Liens on Personal Property Not Accompanied by Possession, Levy, Sequestration, or Distraint of Such Property.

If in light with the foregoing principles, as well as the general over-all purpose of the Bankruptcy Act to avoid secret liens wherever possible, this Honorable Court determines that any statutory trust in favor of the respondent, Security Currency Services, Ltd., should be treated as a statutory lien, then we must examine how a statutory lien should be treated.

Section 67(c)(2) of the Bankruptcy Act provides:

> "The provisions of subdivision (b) of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any state for debts owing to any person, including any state or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee: Provided, however, that so much of clause (1) of this subdivision (c) as restricts liens for wages and rent and clause (2) of this subdivision (c) shall not apply in proceedings under Chapter X of this Act, unless an order shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 77 of this Act. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) and any lien

invalid under clause (2) of this subdivision (c) to be preserved for the benefit of the estate and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee".

It is submitted that we must be careful to distinguish between Section 67(c)(2) of the Bankruptcy Act and Section 67(c)(1), which latter sub-section only subordinates statutory liens to the payment of those items specified in Section 64(a)(1) and 2) of the Bankruptcy Act.

As stated in Volume 4, Collier on Bankruptcy, Section 67.281:

"The most important change in Section 67(c) affected by the amendment of the Bankruptcy Act in 1952 was given but slight attention in the legislative reports which accompanied the measure. That change was the addition of a clause (2), invalidating as against the trustee all statutory liens created or recognized by state law on personal property not accompanied by possession, levy, sequestration or distraint. Its purpose has been explained, however, by one who undoubtedly participated in the drafting, as a further implementation of the objective of the Chandler Act 'to build up, as far as feasible and equitable, the residual fund for distribution among the general unsecured creditors'. It was further suggested that it 'should effectively check the growing trend in state statutes of labeling as 'liens' what essentially are 'priorities' and thereby seek to evade the scheme of priorities as set up in §64(a).'

"Clause (2) of §67(c), like clause (1), is not applicable to liens enforced by sale before the filing of a petition under the Act or to solvent bankrupts' estates. Every lien that falls within the sweep of clause (2) is also within the subordinating language of clause (1). Since invalidation includes subordination and restriction, liens falling within the language of both clauses (1) and (2), must be deemed to be invalidated by the latter clause. As pointed out subsequently, however, situations may arise where both clauses (1) and (2) may apply to a single statutory lien.

"It should be clear, on the other hand, that not every lien that is within clause (1) is within clause (2). The drastic treatment of invalidation under clause (2) is reserved for some only of the liens that are subject to clause (1). A comparison of the wording of the two clauses makes it evident that the following classes of liens coming within the first clause are not invalidated by the second:

(1) Statutory liens arising under federal rather than state law, including liens for taxes or debts owing the United States, on personalty unaccompanied by possession;

(2) Statutory liens arising under state law on personalty unaccompanied by possession but accompanied by levy upon or by sequestration or distraint of the property;

(3) Liens of distress for rent".

The interest created by Financial Code Sections 12300.3 and 12300.4 meets none of these definitions and should fall within the second clause of section 67(c).

Likewise, Remington in his treatise on bankruptcy in Volume 4, Section 1637.1 at page 107 states:

> "Section 67(c), prior to the 1952 amendment thereof, merely postponed such liens, where they were on personalty and 'not accompanied by possession of such property', to the priority of payment accorded to expenses of administration, certain other expenses and wage claims in limited amount by §64(a) of the Act. By one of the 1952 amendments, however, clause (2) of §67(c) is turned into a flat declaration that 'the provisions of subdivision (b) of this section to the contrary notwithstanding', statutory liens 'on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid (italics supplied) against the trustee' ".

B. The Interest Created by Sections 12300.3 and 12300.4 of the California Financial Code Is a State Created Priority, Invalid Under the Chandler Act [Title 11 U.S.C. §104(a)(5)].

Appellees have cited the following California cases in support of their position, to wit:

Bank of America v. Bowden, 46 Cal. 2d 863;

People v. Cole Check Service, 175 Cal. App. 2d 777;

Allen v. Ramsey, 179 Cal. App. 2d 843.

It is submitted that nothing decided by the *Allen v. Ramsey* case has any application here and, likewise, in

the *Cole Check Service* case, the Court limited itself as follows:

> "Two questions are presented: (1) Did the Superior Court have the jurisdiction to appoint a receiver of all of the assets of the defendant corporation, and (2) did the supplemental order describe the assets subject to the receivership with sufficient particularity?"

The *Bank of America v. Bowden (supra)* decision, also does not decide how the sections in question of the Financial Code should be treated in the event of bankruptcy. The Court did hold that the code sections did create a trust and stated:

> "One of the purposes of the legislature in enacting certain provisions of that law which are here involved was to safeguard from the general creditors of the licensed check seller—the funds paid—"

Also, as will be noted from Vol. 15, No. 26, Assembly Interim Committee Reports, 1961-1963, pp. 38-45, the purpose of the legislature in enacting these sections of the Financial Code was to give priority to a certain class of persons in the event of bankruptcy by creating a statutory trust.

It is respectfully submitted that it is up to the Federal Legislature alone to enact statutes affecting bankruptcy priorities.

Prior to the Act of 1938, priorities created by state law were recognized in bankruptcy under Section 64(b)-(7). However, the Act of 1938 substituted Section 64(a)(5) in place of Section 64(b)(7) and it provides:

> "debts owing to any person, including the United States, who by the laws of the United States in

(is) entitled to priority, and rent owing to a landlord who is entitled to priority by applicable state law: Provided, however, that such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy".

As will be noted, priority is given *only* to debts entitled to priority under the *laws of the United States,* save one exception, rent owing to a landlord entitled to priority under state law.

As stated in Vol. 3 Collier on Bankruptcy §64.01 at page 2053:

> "The most extensive change in Section 64 occurred in what under the 1938 Act is the fifth and last class of prior claims—Under this clause persons entitled to priorities under state laws are no longer entitled to prior claims in bankruptcy, except in case of rent; under the corresponding clause of the 1898 Act they were. The change was made in view of supernumerous additions to priority by state legislation, often in conflict with the policy of the Bankruptcy Act".

Collier goes on to say in footnote 27 on pages 2053 and 2054:

> "Regarding this change, it was said in the Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936) 201: 'We have deleted all state priorities except in the case of a landlord—'for like reasons of policy, we have excluded, as indicated, all other state priorities. The necessity for so doing is ob-

> vious; many estates have been consumed, to the exclusion of creditors, by the ever-increasing classes of state priorities' ".

Section 67(b) of the Bankruptcy Act, recognizes valid, perfected liens. So then, under the general scheme of the Bankruptcy Act, unless a creditor is granted priority under a federal statute, or unless he has a valid lien, he is relegated to the position of a general unsecured creditor (with the exception, of course to security devices perfected under state laws).

It is submitted that the California legislature in enacting Financial Code Sections 12300.3 and 12300.4 is attempting to accomplish what Section 64(a)(5) of the Bankruptcy Act seeks to prevent. The subject sections accomplish the same thing as a valid lien would accomplish but by labeling it a trust, the appellees argue that it is not subject to the same invalidating provisions as affect liens.

It is therefore submitted that statutory trusts should be treated, to put it in Collier's words, "in the same way as its functional equivalent, the statutory lien, so far as bankruptcy is concerned".

In the case of *Strom v. Peikes* (2d Cir., 1941), 123 F. 2d 1003, the court was presented with the question of whether or not a bankruptcy court should give effect to a New York statute allowing a priority to wage earners. The trustee argued that the state statute was invalid in light of Section 64(a)(5) of the Bankruptcy Act and the claimant argued that she was en-

titled to a lien status under Section 67(b) of the Bankruptcy Act. The court sustained the trustee's position and stated, on page 1006:

> "Section 67, sub. c, clearly indicates that the preservation of liens under §67, sub. b, covers only liens in the traditional sense of rights attaching to specific property. Subsection c begins, 'Where not enforced by sale.' *Obviously, a right to priority of distribution is not ordinarily enforced by sale.* Furthermore, it is quite clear that the very sort of claim made in this estate was aimed at by the elimination of state laws as a means of obtaining priority under §64, sub. a (5).—
>
> —We should not open a door once closed by broadening the definition of a 'lien' beyond what §67 is meant to cover" (Emphasis added).

In the case of *City of New York v. Feiring* (1941), 313 U.S. 283, 85 L. Ed. 1333, the Supreme Court had before it the question of whether an obligation was a "tax" as defined by Section 64 of the Bankruptcy Act, which is not in point here, however, the court did state, in discussing the Bankruptcy Act:

> "Intended to be nationwide in its application, nothing in the language of §64 or its legislative history suggests that its incidence is to be controlled or varied by the particular characterization by local law of the state's demand. Hence we look to the terms and purposes of the Bankruptcy Act as establishing the criteria upon the basis of which the priority is to be allowed".

It was stated by the court in *In re William Akers, Jr., Co., Inc.* (D.C. E. Dist. Pa., 1940), 31 F. Supp. 900:

> "The priority of claims in a bankrupt estate is determined by the Bankruptcy Act".

C. The Evidence Does Not Support Any Finding of an Express, Constructive, or Resulting Trust.

It is stated in 48 Cal. Jur. 2d *TRUSTS §11:*

> "To constitute a valid express trust, it is essential that there be (1) a trustee, (2) an estate conveyed to him, (3) a beneficiary, (4) a legal purpose, and (5) a legal term. Equity will in some cases make good the absence of a trustee, but if one of the other essentials be lacking, the trust itself must fail".
>
> And 48 Cal. Jur. 2d, TRUSTS goes on to say at Section 16:
>
> "The trust res must be in existence when the trust is created".

The case of *Balian v. Balian's Market* (1941), 48 Cal. App. 2d 150 involved a situation where a father and some of his children agreed that earnings of, and property acquired by, members of the family were to be held in trust for all members of the family by the father as trustee, but, at the time of the agreement, there was no property which could be subject to the purported trust agreement save a sum of money, the property of the father, which had already been turned over to a son and was soon used in living expenses. The court held that there was no trust res, and the agreement was not enforceable in an action to impress a trust upon property subsequently acquired by members of the family and held in the name of the father and one brother.

The court in the Balian case stated on page 156:

> " 'To the creation of a trust, a trust res or subject matter is a *sine qua non* — In order for

trusts to exist there must be an estate to vest in the trustee, and the property must be clearly and definitely pointed out' (*In re Lamb,* 61 C.A. 321)".

Appellee, A. J. Bumb, cited to the District Court the case of *Molera v. Cooper* (1916), 173 Cal. 259 for the proposition that "a mere promise to obtain money and thereupon hold it in trust does not create a trust until it is at least so far executed that the money has been obtained in accordance with the promise".

In the *Molera v. Cooper* case, it was agreed between a Mrs. Wohler and the defendant that in consideration of the extingishment of a certain promissory note by Mrs. Wohler and the release by her of all obligation of the defendant upon said note, the defendant would hold the face amount of the note, plus interest, in trust for two designated beneficiaries.

As the court said (in *Molera v. Cooper*):

> "It is not alleged that the defendant had in her possession or under her control the money owing upon said note, or that she has at any time since procured the same and devoted the same to said trust, or that she was then or has been since, solvent and able to do so".

Further the *Molera v. Cooper* decision stated in clear and unmistakable language:

> "It is clear that no trust was created by the aforesaid arrangement. There never was any property in existence which could be the subject of the trust".

It is submitted that when the court in the Molera v. *Cooper* case said that "a mere promise to obtain money and thereupon hold it in trust does not create a trust until it is at least so far executed that the money has been obtained in accordance with the promise", it was indicating that had the defendant set aside the face amount of the note at the time of the agreement, there would have been a valid trust. It did not hold that a trust could be created on property to arise in the future.

On the contrary, the view expressed in the *Balian's Market* case (*supra*) is the prevailing California view. It expressly held that the trust res *must* be in existence at the time on the purported creation of the trust.

Clearly, there was no trust *res* at the time of the "Agency Franchise and Trust Agreement".

There being no trust *res* in existence at that time, there could be no express, constructive or resulting trust and any "trust" was created by virtue of Sections 12300.3 and 12300.4 of the California Financial Code.

D. Even if the Interest Created by Financial Code Sections 12300.3 and 12300.4 Is Not Treated as a Lien, Beneficiaries of a Trust, Whether Statutory or Otherwise, Must Trace the Trust Res, Which Appellees Have Failed to Do.

The District Court's Order reversing the Referee, although not specific, necessarily must be interpreted to hold that a "trust" exists in favor of the appellee on the funds held by the Credit Managers Association of Southern California, as well as the funds in the hands of the trustee in bankruptcy which represents the proceeds from the liquidation of the now bankrupt's general assets.

The ultimate result of appellees' contention is that the appellee, A. J. Bumb, as trustee of the estate of Security Currency Services, Ltd., has a trust charge or lien on the sales proceeds of the stock in trade and fixtures of Van's Market, the allowance of which would defeat the unpaid trade creditors of Van's Market, and in this particular case would, in effect, dedicate the bankrupt estate to one creditor.

Even the Internal Revenue Code, which provides for a trust in favor of the United States for withholding taxes does not dispense with the requirement that the beneficiary trace the trust property into specific property in the hands of a trustee in bankruptcy.

Title 26 United States Code, Section 7501(a) provides:

> "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose".

In the case of *Hercules Service Parts Corp. v. United States* (6th Cir., 1953) 202 F. 2d 938, the court said, in discussing Section 7501(a) (Section 3661 under the 1939 Code):

> "It is the general rule that *a trust cannot be impressed* for the benefit of the cestui que trust *unless the trust property is identified or the corpus*

of the trust is traced into some specific fund or thing into which the original trust property has passed in some form. The Congress in Section 3661, when it provided in effect that any person required to collect or withhold any internal revenue taxes is a trustee for the amount of such taxes, did not dispense with the test for the recovery of diverted trust funds. Here the diverted trust funds are not identified and no evidence exists that the assets of the debtor were augmented by the payments" (emphasis added).

However, the court did go on to hold that where the "diversion" of the "trust funds" was made *after* bankruptcy by a debtor in possession the requirement of tracing did not exist. As the court stated on page 940:

> "However, this is not a case in which the diversion took place prior to reorganization proceedings. In such case the tracing of the trust funds would still be necessary in order to justify giving priority to the beneficiary of the trust. *City of New York vs. Rassner,* 2nd. Cir., 127 F. 2d 703; *Elmer Co., Ltd. v. Kemp,* 9th Cir., 67 F. 2d 948. . . .
>
> "Since the funds were diverted by an officer acting under the authority and control of the court the obligation of tracing the trust corpus does not exist".

It is submitted, that in the instant case, since the alleged "diversion" or "commingling" took place prior to bankruptcy, the law is abundantly clear that the appellees must bear the burden of tracing the "trust" funds, *which they have not done.*

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

Robert A. Fisher

APPENDIX.

CALIFORNIA FINANCIAL CODE §12300.3:

All funds received by a licensee or its agents from the sale of checks, drafts, money orders, or other commercial paper serving the same purpose and for the purpose of paying bills, invoices, or accounts of an obligor, equal in amount to the face value of such instruments or equal to the amount to be paid, shall constitute trust funds owned by and belonging to the person from whom they were received or a licensee who has paid the checks, drafts, money orders or other commercial paper serving the same purpose, for which the funds of such persons have been received by the agent but not transmitted to such licensee or deposited in the trust account of such licensee. If a licensee or an agent of a licensee shall commingle such funds with those of his own, all assets of such agent shall be impressed with a trust in favor of said purchaser or the licensee in an amount equal to the aggregate funds received or which should have been received by the agent from such sale. Such trust shall continue until an amount equal to said funds is separated from those of the agent and transmitted to the licensee or deposited in the trust account of licensee. An amount equal to all such trust funds shall be deposited in a bank or banks in an account or accounts in the name of the licensee designated "trust account," or by some other appropriate name indicating that the funds are not the funds of the licensee or of its officers, employees, or agents. Such funds, or, in the event of the commingling of such funds by licensee or its agent with those of the licensee or its agent, an amount of funds of such licensee or of its agent equal thereto, shall constitute trust funds as herein provided

and shall not be subject to attachment, levy of execution or sequestration by order of court except by a payee, or bona fide assignee, or bona fide holder in due course of a check, draft, or money order sold by a licensee, or except by an obligor for whom a licensee is acting as an agent in paying bills. Funds in said account, together with funds and checks on hand and in the hands of agents held for the account of the licensee, at all times shall be at least equal to the aggregate liability of the licensee on account of checks sold and bills, invoices, and accounts accepted for payment.

Nothing in this law shall be construed to prevent a purchaser, a holder in due course, the payee of a check, draft or money order sold by the licensee in the usual course of his business, or an obligor for whom the licensee is acting as an agent in paying bills of the obligor, from taking any legal action necessary to enforce any claims which said purchaser, holder in due course, payee or obligor may desire to take including the right to levy attachment or execution.

In the event a license under this law shall be suspended or terminated the licensee shall immediately deposit in said trust account an amount which with funds therein contained shall be equal to the outstanding checks sold and bills unpaid. (Added Stats. 1963, c. 1817, p. 3745, § 6.)

CALIFORNIA FINANCIAL CODE §12300.4:

Prior to such separation and transmittal to the licensee or deposit by its agent such funds received by said agent may be used by said agent for the sole purpose only of the making of change or cashing of checks in the normal course of its business. All such funds

received by said agent to the date of deposit or transmittal as required below or an amount equal to such funds must be separated from those of the agent and transmitted to, or deposited in the trust account of, the licensee not less than every third business day. If an agent owns or operates, either directly or indirectly, more than two locations for the sale of checks, drafts, money orders, or other commercial paper serving the same purpose and/or for the receipt of money for the purpose of paying bills, invoices or accounts of an obligor, and handles trust funds in any three-day period equal to or in excess of securities to be deposited as provided in Section 12223, said agent shall transmit to, or deposit in the trust account of, the licensee directly from each such location of such agent such funds not later than the end of the next business day following receipt; such funds to be in form of cash or checks cashed in the normal course of business only.

Where the total amount of such funds held by an agent does not exceed one thousand dollars ($1,000) in a calendar week, the commissioner may, in his discretion, by written order permit the agent to transmit or deposit such funds in periods in excess of 3 days but not more than 10 days.

If, after reasonable notice from licensee, an agent shall fail to transmit or deposit the funds, or an amount equal thereto, or to report to the licensee, as herein provided without just cause, or if an agent shall use any of such funds, directly or indirectly, for any purpose other than is permitted herein, licensee shall immediately terminate such agency and within five (5) days thereafter notify the commissioner in writing of the reason

for such termination, setting forth the name and a
dress of the agency location. No agent so terminat
shall be permitted to become an agent of the licens
or any other licensee except as provided in Secti
12301.4 of the Financial Code. (Added Stats. 196
c. 1817, p. 3746, §7.)

NO. 20095 1

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PETER M. ELLIOTT, Trustee for
VAN'S MARKET, a copartnership
composed of KENNETH M. PRICE
and WILLIAM R. BABINEAU.

Appellant,

v.

A. J. BUMB, Trustee for
SECURITY CURRENCY SERVICES,
LTD., and CORPORATIONS
COMMISSIONER OF STATE OF
CALIFORNIA,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION

BRIEF OF APPELLEE CORPORATIONS
COMMISSIONER OF THE STATE OF CALIFORNIA

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State of California

TOPICAL INDEX

LIST OF AUTHORITIES CITED

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

[illegible] M. ELLIOTT, Trustee for VAN'S MARKET, a copartnership composed of KENNETH M. PRICE and WILLIAM F. BARINEAU, Appellant, v. A. J. BUMB, Trustee for SECURITY CURRENCY SERVICES, LTD., and CORPORATIONS COMMISSIONER OF STATE OF CALIFORNIA, Appellees.	No. ______

BRIEF OF APPELLEE CORPORATIONS COMMISSIONER OF THE STATE OF CALIFORNIA

INTRODUCTORY STATEMENT

As is set forth at pages 4-5 of Appellant's Opening Brief, the Corporations Commissioner of the State of California has no monetary interest or claim to the funds in question here. However, the Corporations Commissioner is charged with the responsibility of enforcing the Check Sellers and Cashers Law (set forth at sections 12000, et seq. of the Financial Code of the State of California) and in carrying out this responsibility, is deeply concerned with the interpretations placed upon said law by any court in which an interpretation becomes necessary.

JURISDICTIONAL STATEMENT

Appellee Corporations Commissioner of the State of California (hereinafter sometimes referred to as "commissioner") adopts by reference the jurisdictional statement of appellant set forth at pages 2-3 of Appellant's Opening Brief.

STATEMENT OF FACTS

The facts relating to this proceeding are satisfactorily set forth in Appellant's Opening Brief at pages 3-5.

Supplementary thereto, appellee commissioner brings to the attention of the court that the "Agency Franchise and Trust Agreement" entered into by Security Currency Services, Ltd., (hereinafter sometimes referred to as Security Currency) and Van's Market on November 15, 196[illegible], contains the following pertinent language:

> ". . . Security Currency . . . does hereby appoint Van's Market . . . as its Agent for the purpose of issuing Money Orders.
>
> "1. Agent shall accept responsibility and liability for properly issuing all Money Orders and shall account for and remit all proceeds for face value issued plus 50% of fees therefrom to Security; Agent shall hold all said moneys in trust for Security entirely separate and apart from other funds in possession of Agent until remitted. . . ." (R-134.)

THE COMMINGLING BY YAN'S MARKET OF $1,099.17 WHICH IS HELD IN TRUST FOR APPELLANT [illegible] IMPRESSED THE [illegible] ASSETS OF YAN'S MARKET WITH A TRUST IN SAID AMOUNT IN FAVOR OF APPELLANT [illegible] IN THAT AMOUNT. NEITHER SECTION 67(c)(1) NOR SECTION 64(a)(5) OF THE BANKRUPTCY ACT INVALIDATES SAID TRUST INTEREST

A. The California Law Including Financial Code Section 12300.3

Section 12300.3 of the California Financial Code provides in pertinent part:

"All funds received by a licensee or its agents from the sale of . . . money orders . . . shall constitute trust funds owned by and belonging to the person from whom they were received or a licensee who has paid the . . . money orders . . . for which the funds of such persons have been received by the agent but not transmitted to such licensee or deposited in the trust account of such licensee. If . . . an agent of a licensee shall commingle such funds with those of his own, all assets of such agent shall be impressed with a trust in favor of said purchaser or the licensee in an amount equal to the aggregate funds received or which should have been received by the agent from such sale. Such trust shall continue until an amount equal to said funds is separated from those of the agent and transmitted

to the licensee or deposited in the trust account of licensee. . . ."

This section was designed to preserve the integrity of trust funds and, if the agent of the check seller commingled funds which he held in trust with his own assets, then to impress a trust upon all the assets of the agent so as to further preserve the integrity of the funds. That the legislation was designed to cope with the problem of tracing commingled trust funds (rather than establishing a priority to assets) is found from that part of the Final Report of the Assembly Interim Committee on Finance and Insurance of the State of California which deals with the problem. Cal. Int. Comm. Final Rep. on Finance and Insurance, 41-42; 1 (1963) Cal. Assem. J. app.

While it is clear that the committee was concerned with the effect of bankruptcy on the funds held by the agent consisting of proceeds from the sale of money orders, it is also abundantly clear that the committee (and the State Legislature) was not concerned with giving one type of debtor a priority in any bankruptcy proceeding that might result but rather assuring the purchasers of money orders that they would be honored and assuring the check seller that upon his honoring and paying such money orders, he would receive the moneys which the agent was holding in trust for him. If the

agent commingled the funds held in trust, a trust was impressed upon his assets until the sum was separated out and paid to the principal.

Section 12304.5 of the Financial Code was designed to implement the California law on the principal-agent relationship which in and of itself establishes the trust relationship existing between principal and agent.

That an agent is treated as a trustee in California is shown by section 2322 of the California Civil Code:

> ". . . An authority expressed in general terms, however broad, does not authorize an agent:
>
> ". . .
>
> "3. To do any act which a trustee is forbidden to do by [sections 2228-2239 of the Civil Code (dealing with obligations of trustees)]."

Under this section an agent may not do any act which a trustee is forbidden to do. Darrow v. Robert A. Klein & Co., Inc., 111 Cal. App.310, 316 (1931),295 P. 566. An agent is a fiduciary and his obligation of diligent and faithful service is the same as that imposed upon a trustee. Rodes v. Shannon, 222 Cal. App. 2d 721, 725 (1963),35 Cal. Rptr. 339; Spector v. Miller, 199 Cal. App. 2d 87, 95 (1962),18 Cal. Rptr. 426. It goes without saying that a trustee or agent who wrongfully

remainder the court shall for the benefit of the bene- ficiary or principal with [illegible] in addition an involuntary trustee or constructive trustee of those assets. Cal. Civ. Code, §§ 2223, 2224; Angelus Securities Corp. v. [illegible], 47 Cal. App. 2d [illegible], [illegible] (1941).

Many jurisdictions, as a matter of common law, hold that a trustee who uses trust assets to pay his own debts holds all his other assets in trust for the benefi- ciary of the trust to the extent that trust assets were diverted from the trust. See Bogert, Trusts and Trustees (2d ed. [illegible]) § 9[illegible], pp. 309-10; Taft, A Defense of a Limited Use of the Swollen Assets Theory Where Money has Wrongfully been Mingled with Other Money. 39 Col.L.Rev.172.

This, then, is the force of section 1[illegible]300.3 of the Financial Code.

F. The Trust Relationships Established by California Law and Financial Code Section 1[illegible]300.3 Are Not Invalidated by Section [illegible] of the Bankruptcy Act

The trust relationships between [illegible] Market and [illegible] by statute and general law are recognized as such by the Bankruptcy Act. (All sectional references are to the Bankruptcy Act unless otherwise indicated.) The creation of rights in property and trust relationships therein is wholly a local question and the federal court will observe such rights and relationships. [illegible], 34 F. Supp. 109-11 (W. D.

N.Y. 1940); see also [illegible] v. [illegible] Bank of New York, 206 U.S. 28, 37-38 (1906).

Section 67(c)(2) provides in pertinent part as follows:

> ". . . [S]tatutory liens created or recognized by the laws of any State for debts owing to any person . . . on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee. . . ."(Emphasis added.)

The purpose of this section,

> ". . . was to invalidate against the trustee claims which were essentially priorities, but which States had labeled 'liens' in an effort to avoid the order of distribution established by Section 64, 11 U.S.C.A. § 104." In re Baron, 165 F. Supp. 186, 188 (D. Conn. 1958).

Appellant urges that section 67(c)(2) invalidates Security Currency's interests in the assets turned over to the trustee of Van's Market but this contention cannot stand for the following independent reasons:

1. As is shown in this brief, supra, the assets of Van's Market are impressed by section 1.300.3 with a trust, not a lien, in favor of Security Currency where Van's Market commingles trust funds with its own.

Appellant, relying on 4 Collier on Bankruptcy

(14th ed. 1964) [illegible], hence the trust expressed by Section 12300.5 of the Financial Code should be treated functionally as a statutory lien within the meaning of section 67(c)(2) of the Bankruptcy Act and invalidated. Neither Collier nor appellant gives authority in support of the general proposition that some statutory trusts may be treated as statutory liens or that the trust here should be so treated. Congress added clause 2 to section 67(c) in 1952 and there existed at that time cases, such as *In re Heintzelman Const. Co.*, 34 F. Supp. 109 (W.D.N.Y. 1940), wherein the court had differentiated statutory trusts from statutory liens and found section 67 of the Bankruptcy Act inapplicable to the former. Under these circumstances, Congress' failure to include statutory trusts within the language of clause 2 of section 67(c) hardly supports appellant's position and in fact leads to a contrary interpretation of those provisions. See *Campbell v. Street*, 194 F. 2d 228, 230-32 (9 Cir. 1951), *cert. denied*, 343 U.S. 927. It should also be noted that Collier itself recognizes that section 67(c) of the Bankruptcy Act has no application if the statutory trust is analogized to a constructive trust (4 *Collier on Bankruptcy*, *supra*, 122) and that recognition of statutory enactments creating trusts in favor of certain persons has been generally regarded by bankruptcy courts as a matter of

applying and following local laws (4 Collier on Bankruptcy 1210).

No reasons are suggested by appellant for treating the trust here as a lien and indeed none can be suggested upon an analysis of the relationships existing between the seller of the money order (Security Currency) and its agent (Van's Market). The policy behind section 67(c)(2) is apparently to protect unsecured creditors against state-created priorities for what would otherwise also be unsecured creditors. However as has been shown above, the relationship between Security Currency and its agent (Van's Market) is not one of creditor to debtor, but rather of principal to agent and beneficiary to trustee. Recognition of the provisions of section 12300.3 does not prefer Security Currency as an unsecured creditor over other unsecured creditors but merely enforces the trust and fiduciary relationship which always exists between principal and agent.

Even accepting (solely for the sake of argument) that one may look to the function of the statutory trust in an effort to determine whether it should be invalidated by section 67(c)(2), it is clear here that in no way should Security Currency's interest be looked upon as a statutory lien or as a device to give one type of creditor a priority.

That part of section 12300.3 of the Financial Code with which we are here concerned is merely a

[illegible] upon trust funds being commingled and Van's Market holds its assets in constructive trust for Security Currency until it has separated out and paid to Security Currency the sums which it had commingled with its own assets.

2. Section 67(c)(2) invalidates only statutory liens for debts. The relationship between Van's Market and Security Currency is not that of debtor-creditor but that of trustee-beneficiary such as exists between an agent and his principal. The fact that the trustee commingles trust assets with his own does not change the relationship to that of debtor-creditor. Noble v. Noble, 198 Cal. 129, 133-34 (1926), 243 P. 439; Hunter v. Janes, 9 Cal. 643, 659 (1858), ("It is difficult to perceive how, in sound logic or in simple justice, a trustee, by his own voluntary act, may change his capacity, and convert himself into a mere debtor. . . ." Burnett, J., on petition for rehearing.) Since the invalidating provisions of section 67(c)(2) are applicable only to statutory liens for debts, Rochelle v. City of Dallas, 264 F. 2d 166 (5 Cir. 1959), cert. denied 361 U.S. 827; In re Baron, 165 F. Supp. 186, 188 (D. Conn. 1958), it has no application to the case at hand.

In the instant case Credit Managers Association realized $2,987.56 as proceeds from the liquidation of assets of Van's Market and trust moneys in the amount of

$1,094.17 commingled by Van's Market with its assets. Because of the fact that Van's Market had commingled trust funds with its own, these proceeds in liquidation were impressed with a trust in favor of Security Currency in that amount. Until that sum is extracted and paid to Security Currency these liquidation proceeds remain impressed with that trust and never become a part of the bankrupt estate of Van's Market.

C. Security Currency's Interest Is Not Invalidated by Section 64(A)(5) of the Bankruptcy Act

Appellant urges that the trust impressed by section 12300.3 is a state created priority which is invalid under section 64(a)(5) of the Bankruptcy Act. App. Op. Br. pp. 22-26. However, section 64 invalidates nothing but merely designates the order and extent of priority of various types of claims to assets of the bankrupt's estate.

It nowhere determines what assets in the possession of the bankrupt are a part of his estate and what assets are not. It is well settled that assets which a bankrupt holds in trust for another do not become a part of his estate. See 4 Collier on Bankruptcy 1204. Therefore, section 64 of the Bankruptcy Act has no applicability.

D. <u>The Trust Res Established Is Adequately Traced to the Moneys Turned over by Credit Managers Association to the Trustee in Bankruptcy of Van's Market</u>

Appellants further assert that Security Currency has failed to trace the trust res as it is required to do. To the contrary, the trust impressed by section 12300.3 of the Financial Code is upon all the assets of Van's Market to the extent and until the $1,094.17 is paid over to Security Currency. The proceeds realized by Credit Managers Association from the liquidation of this $1,094.17 together with the assets of Van's Market is taken by the trustee in bankruptcy subject to the trust obligation. 4 <u>Collier on Bankruptcy</u> 1203.

II

THE $2014.99 PAID BY CREDIT MANAGERS ASSOCIATION AND REPRESENTING MONEY ORDERS SOLD BY VAN'S MARKET AND PAID BY SECURITY CURRENCY ARE CLEARLY HELD IN TRUST FOR SECURITY CURRENCY. NEITHER SECTION 64(A)(5) NOR SECTION 67(C)(2) SERVE TO INVALIDATE THIS TRUST RELATIONSHIP AND SECURITY CURRENCY'S INTEREST IN SAID TRUST

(The arguments heretofore made in respect to the sum of $1,094.17 commingled by Van's Markets are just as applicable to the $2,014.99 which is the subject of the discussion here. To avoid repetition and because even more compelling reasons dictate that the District Court's order as respects this sum be affirmed, they are

not repeated.)

Credit Managers Association holds $2,014.99 representing moneys on deposit in a Van's Market account and representing money orders sold by Van's Market for Security Currency and which money orders had been honored and paid by Security Currency.

By agreement Van's Market agreed to hold such money "in trust for Security [Currency]." (R-134.) Under general California law, Van's Market as agent of Security Currency for the purpose of selling the latter's money orders, held the proceeds in trust for Security Currency. Since it has been stipulated and found as a fact that this $2,014.99 represents money orders sold by Van's Market for Security Currency, no question whatsoever arises in regard to tracing the trust res.

Section 67(c)(2) clearly does not invalidate Security Currency's trust interest since that interest is not based on statute (although section 12300.3 of the Financial Code also establishes this trust relationship to the funds in question) but on the principal-agent relationship between Security Currency and Van's Market and their express agreement relating to the status of funds received by Van's Market in the sale of Security Currency money orders.

In addition to Security Currency's interest

not being a lien and not being a lien for a debt, it is not invalidated by section 67(c)(2) of the Bankruptcy Act because it arose from the terms of its contracts and not from an economic relationship defined by the legislature. In re New Haven Clock & Watch Company, 253 F. 2d 577, 582 (2 Cir. 1958). That section 64(a)(5) of the Bankruptcy Act presents no problems is manifested by the discussion, supra, page 11.

Appellant argues that no trust exists under the Agency Franchise and Trust Agreement because no identifiable trust res existed at the moment the contract was signed. However, a declaration of trust may precede acquisition of the trust res and attach to it thereafter. Grubb v. General Contract Purchase Corporation, 94 F. 2d 70, 73 (2 Cir. 1938); see also Rest. of the Law, Trusts 2d (Vol. 1, 1959) § 26, Comment K; Bogert, Trusts and Trustees (2d ed.) § 113, pp. 575-76. This rule has been adopted in California by the dictum in Molera v. Cooper, 173 Cal. 259, 262 (1916), 160 P. 231:

> ". . . A mere promise to obtain money and thereupon hold it in trust does not create a trust until it is at least so far executed that the money has been obtained in accordance with the promise. . . ."

In support of his position appellant cites Balian v. Balian's Market, 48 Cal. App. 2d 150 (1941), 119 P. 2d 426. That case involved an alleged oral

trust whereby a father and two of his sons agreed that the earnings of all the members of the family (this included five other children) whould be placed in a common fund and all property acquired placed in the name of the father to be distributed in a certain fashion upon the father's death. In holding that the trial court properly nonsuited the proceeding by three of the children to impress a trust upon certain property of the father and of two of the other children, the court noted that,

1. At the time the trust agreement was entered into, most of the children (including the two who were defendants) were minors;

2. There was no trust res because the $160 which the father held at the time of the alleged agreement had been used up in living expenses; and

3. The terms of the alleged agreement were altogether too uncertain and tenuous to have warranted the trial court impressing a trust upon any property. Rather than holding that no trust can arise from an agreement to hold subsequently acquired property in trust, the court rather emphasizes the uncertainty of the agreement.

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SUMMARY OF ARGUMENT

Section 67(c)(2) of the Bankruptcy Act does not invalidate the trust impressed upon the assets of the agent of a check seller who commingles assets held in trust for the check seller with his own since,

1. Section 67(c)(2) applies only to statutory liens, not trusts; and

2. Section 67(c)(2) invalidates only statutory liens for debts and not interests arising out of the principal-agent or trustee-beneficiary relationship. The assets upon which the trust is impressed is traced into the proceeds realized by Credit Managers Association upon liquidation of the assets of Van's Market and the trust funds commingled therewith which liquidation proceeds were turned over by Credit Managers Association to the trustee in bankruptcy of Van's Market. Since these assets were held in trust in favor of Security Currency until the amount of trust funds commingled therewith had been separated and paid over to Security Currency, they do not become a part of the bankruptcy estate of Van's Market and section 64(a)(5) of the Bankruptcy Act has no application.

The $2,014.99 held by Credit Managers Association and representing money orders sold by Van's Market and paid by Security Currency are funds held in trust for Security Currency by agreement. Neither section

64(a)(5) nor section 67(a)(3) are in any way applicable to invalidate the trust relationship and the trustee in bankruptcy of [illegible] Market has no claim whatsoever to said funds.

It is respectfully submitted that the order of the District Court should be affirmed.

DATED: August 25, 1965

THOMAS C. LYNCH, Attorney General

By ARTHUR C. DE GOEDE
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CERTIFICATE.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

ARTHUR C. DE GORDE
ARTHUR C. DE GORDE

STATE OF CALIFORNIA }
} SS
COUNTY OF LOS ANGELES }

[illegible], being first duly sworn, deposes and says:

That affiant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of twenty-one years and not a party to the within action;

That on August 25, 1965, affiant served the within BRIEF OF APPELLEE CORPORATIONS COMMISSIONER OF THE STATE OF CALIFORNIA upon persons listed below by depositing a true copy thereof in a United States mail box at Los Angeles, California, in a sealed envelope with postage thereon fully prepaid and addressed as follows:

[illegible]
458 South Spring St., No. 812
Los Angeles, California 90013
Attn: Robert A. Fisher, Esq.

[illegible]
408 South Spring St., Suite 408
Los Angeles, California 90013
Attn: Robert W. Alberts, Esq.

That there is a regular communication by mail between the place of mailing and the place so addressed.

[illegible]
[illegible]

Subscribed and sworn to before
me this 25th day of August, 1965

[illegible]
[illegible]
Notary Public in and for said
County and State

No. 20095

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PETER M. ELLIOTT, as Trustee in Bankruptcy of the Estate of Van's Market, a Co-partnership composed of KENNETH M. PRICE and WILLIAM R. BABINEAU, Bankrupt,

Appellant,

vs.

A. J. BUMB, as Trustee in Bankruptcy of the Estate of Security Currency Services, Ltd., Bankrupt, and CORPORATION COMMISSIONER FOR THE STATE OF CALIFORNIA,

Appellees.

BRIEF OF APPELLEE A. J. BUMB.

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No. 20095

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Appellant,

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Appellees.

BRIEF OF APPELLEE A. J. BUMB.

I.

Statement of Case.

For convenience and brevity, the parties and entities involved in this appeal are herein referred to as follows:

Peter M. Elliott, as Trustee in Bankruptcy of the Estate of Van's Market, a co-partnership (Applicant and Appellant): Trustee.

A. J. Bumb, as Trustee in Bankruptcy of the Estate of Security Currency Services, Ltd., bankrupt (Respondent and Appellant): Bumb.

Van's Market, a co-partnership composed of Kenneth M. Price and William R. Babineau (Bankrupt): Van's.

Security Currency Services, Ltd.: Security.

Corporation Commissioner for the State of California (Respondent and Appellee): Commissioner.

Credit Managers Association of Southern California: Association.

On September 18, 1964, Trustees filed an Application for Order to Show Cause against the Association, Bumb, and the Commissioner, to require them to show cause why orders should not be entered declaring "any statutory lien" in favor of Bumb, Security, or the Commissioner, with respect to any funds of the within bankruptcy estate to be null and void pursuant to Section 67(c)(2) of the Bankruptcy Act (11 U.S.C. §107) and ordering the Association to remit to Trustee the balance of the funds of the bankrupt which it held at that time. [R. 2-4.] Such an Order to Show Cause issued on September 18, 1964. [R. 5-6.] The Answer filed by Bumb to the Application alleges that he asserts not a "statutory lien" as set forth in Section 67(c)(2) of the Bankruptcy Act, but rather, a trust fund as expressly provided in Section 12300.3 of the California Financial Code, which trust fund is not a statutory lien under the aforesaid Section of the Bankruptcy Act. [R. 81-82.] The Commissioner, in his answer to the Application, likewise takes the position that the funds in question are held in trust as specifically and expressly provided for in Section 12300.3 of the California Financial Code. [R. 84-86.] The Association did not file an Answer herein.

An Order of the Referee was entered adjudging that any trust created in favor of Security pursuant to Sections 12300.3 and 12300.4 of the California Financial Code is wholly invalid against the Trustee herein pursuant to Section 67(c)(2) of the Bankruptcy Act and that the funds in question are assets of the within estate, free and clear of any right, title, lien or other interest whatsoever in favor of Security, and ordering the Association to turn over to Trustee the funds in question which it held. [R. 123.] Bumb and the Commissioner petitioned for Writ of Review by the United States District Judge. [R. 7-15; 16-24.]

On review, the United States District Court determined that proceeds from the sale of money orders and checks by Van's as agent for Security, whether deposited to a trust account or comingled with assets of Van's, constitute trust funds which are not subject to the provisions of Section 67(c) of the Bankruptcy Act, reversed the order of the Referee, and ordered the cause recommitted to the court below. [R. 79-80.] This appeal by Trustee followed.

II.

Summary of Facts.

The case at bar has been briefed and argued before the Referee based upon a Stipulation of Facts [R. 109-111] and before the District Court upon said Stipulation of Facts and a written Agency Franchise and Trust Agreement [R. 134-135] which agreement was admitted in evidence before the District Court pursuant to a Stipulation to Admit Additional Evidence [R. 76] and Order 47 of the General Orders in Bankruptcy. As Trustee, in his Opening Brief, has alleged that the

Commissioner and Bumb have failed to trace the trust *res,* it is thought necessary to briefly reiterate the facts set forth as aforesaid.

On or about November 15, 1962, a written Agency Franchise and Trust Agreement was executed by and between Van's and Security, by which Security appointed Van's its "Agent for the purpose of issuing Money Orders". [Ex. "A"; R. 134-135.] Under paragraph 1 of said Agreement, Van's agreed to hold all proceeds for the face value of money orders issued, plus 50% of the fees therefrom, in trust for Security, and entirely separate and apart from other funds in Van's possession. [*Id.*] In paragraph 12 of said Agreement, Van's acknowledged receipt of 200 of the subject money orders from Security. [*Id.*]

On October 15, 1963, Van's executed a general assignment for the benefit of creditors to the Association, and Van's ceased doing business on said date. [R. 110.] Subsequently, on November 19, 1963, an Involuntary Petition in Bankruptcy was filed against Van's; Van's was adjudged a bankrupt on March 5, 1964; and Trustee is the duly appointed, qualified, and acting trustee of the within estate. [R. 109.]

For the period preceding October 15, 1963, there is due to Security from Van's the sum of $3,092.99, representing proceeds from the sale of money orders and checks sold by Van's as agent for Security, together with the additional sum of $16.17 representing fees for the sales of checks, making a total obligation due from Van's to Security of $3,109.16, all money orders and checks for which were honored and paid by Security. [R. 110.] The Association is presently holding the sum of $2,014.99, which sum represents moneys

which were on deposit in Van's bank account prior to October 15, 1963, at Bank of America, Harbor and Palm Branch, Los Angeles, California, and which represented money orders sold by Van's for Security. [*Id.*] (The Association has been found to be asserting no claim to said funds and to merely be seeking a determination as to what should be done with them. [R. 121.] To the best of the knowledge of the undersigned, said finding of the Referee has not been and is not now contested.) The difference between the total obligation due from Van's to Security ($3,109.16) and the sum of $2,014.99 being held by the Association (*i.e.,* $1,094.17) was commingled by Van's with its other assets. [R. 110.] Said assets were liquidated by the Association and the proceeds, in the sum of $2,987.56, were turned over by the Association to Trustee. [R. 121; Op. Br. p. 4.]

Security filed a Petition under the terms of Chapter 11 of the Bankruptcy Act on January 16, 1964, and was later adjudged a bankrupt. Bumb is the trustee in that matter, being Bankruptcy No. 166114-TC in the United States District Court, Southern District of California, Central Division [R. 120; Op. Br. p. 4], and the Commissioner asserts no claim to the funds held by Trustee for the Association, but is charged with the responsibility of enforcing the Check Sellers and Cashers Law set forth in Sections 12000, *et. seq.* of the California Financial Code. [R. 85, 121.]

III.

ARGUMENT.

1. The District Court Did Not Err in Finding That Proceeds From Sale of Money Orders and Checks by Van's as Agent for Security, Whether Deposited to a Trust Account or Commingled With Assets of Van's, Constitute Trust Funds, Which Trust Funds Are Not Subject to the Provisions of Section 67 (c) of the Bankruptcy Act.

A. A Careful Examination of Section 12300.3 of the California Financial Code Reveals That the Trust in Question Has Its Origins in Equity and the Law of Agency, and, Even if It Is Determined to Be a Statutory Trust, It Is Clearly Analogous to an Express or Constructive Trust.

By enacting the Check Sellers and Cashers Law set forth in Provision 3 of the California Financial Code, Section 1200 *et seq.* the California Legislature has provided a format for careful regulation of persons and business entities occupying positions in the business world of this State identical to those occupied by Security and Van's. The Law provides licensing requirements and regulatory provisions to be administered and enforced by the Commissioner of Corporations of the State of California. We are here primarily concerned with Section 12300.3 of said Law which provides, in relevant part,

> "All funds received by a licensee or its agents from the sale of checks, drafts, money orders, or other commercial paper serving the same purpose . . . equal in amount to the face value of such instruments . . . shall constitute *trust funds* owned by and belonging to the person from whom they were

received *or a licensee who has paid the checks, drafts, money orders or other commercial paper* . . . for which the funds of such persons have been received by the agent but not transmitted to such licensee or deposited in the trust account of such licensee. If a licensee or an agent of a licensee shall commingle such funds with those of his own, all assets of such agent shall be impressed with a *trust* in favor of said purchaser or the licensee in an amount equal to the aggregate funds received or which should have been received by the agent from such sale. Such *trust* shall continue until an amount equal to said funds is separated from those of the agent and transmitted to the licensee or deposited in the trust account of licensee. An amount equal to all such *trust funds* shall be deposited in a bank or banks in an account or accounts in the name of the licensee designated 'trust account,' or by some other appropriate name indicating that the funds are not the funds of the licensee or of its officers, employers, or agents. Such funds, or, in the event of the commingling of such funds by licensee or its agent with those of the licensee or its agent, an amount of funds of such licensee or of its agent equal thereto, shall constitute *trust funds* as herein provided. . . ." (Emphasis added.)

Trustee alleges that any trust created in favor of Security pursuant to Section 12300.3 of the California Financial Code is a statutory trust. (Op. Br. p. 9.) Without unduly engaging in an argument over semantics, it is respectfully submitted that said allegation is not necessarily correct. Careful examination of the subject Section reveals that it refers to at least two, and possibly

three, trusts. One trust is for the benefit of the purchaser of the check, draft, money order, or other commercial paper; the second trust is for the benefit of the licensee (Security in the case at bar). The Section, in addition, provides that all assets of a commingling agent "shall be impressed with a trust" in favor of such purchaser or licensee; it appears that this language may be interpreted as providing a remedy for the party or parties injured by the commingling, or, in the alternative, as referring to a trust which is analogous to a resulting or constructive trust. It is the second trust (*i.e.,* the trust for the benefit of Security) and the remedy or third trust with which we are herein concerned.

The editors of *Collier on Bankruptcy,* in their discussion of Section 67 of the Bankruptcy Act, note that it is not always easy to label a lien as being statutory or nonstatutory in nature. *4 Collier on Bankruptcy,* paragraph 67.20, page 184 (14th Edition, 1964). The treatise goes on to say,

> "thus, the lien of distress for rent, may at times seem to be no more than a common law variety of lien; yet statutes may regulate or modify the remedy. The same difficulty may arise as to other types of liens having common law origins and modern statutory refinements. An issue in such cases is whether the legislation has supplanted the common law lien or has created an additional lien. If the statute is supplementary, thereby recognizing a common law lien while creating a new statutory lien, the question arises: in what category does the asserted lien belong? There may even be difficulty in distinguishing between liens that are contractual and those that are statutory within subdivisions

(b) and (c). It is suggested, however, that the lien created or recognized by statute within the meaning of Section 67 arises primarily from an economic relationship defined by the legislature and not from the terms of the contract providing for security. The doctrine of *eiusdem generis* plainly applies. By this test the security of the trust receipt or mortgage on a shifting stock of merchandise, the factor's lien, or a secured transaction within Article 9 of the Uniform Commercial Code is contractual rather than statutory, even though without the statute the agreement of the parties would not effectively create a lien valid under non-bankruptcy law.

"Whether a lien exists within Section 67 (b) is ordinarily said to be determined by reference to the law of the state where the property is located. The policy of the Banruptcy Act to distinguish carefully between liens and priorities may, however, oblige the court to peer behind the label fastened on a particular interest by state law to discover whether what is there denominated a lien is actually, as a matter of bankruptcy law, no more than a priority." [*Id.*]

It is submitted that the question of whether or not the subject trust (or trusts) is a "statutory" trust, particularly in view of the fact that Trustee maintains that the trust in question should be treated as a lien under Section 67(c)(2), lends itself to the foregoing analysis. Specifically, it is not disputed that Van's was, at all times relevant herein, an agent of Security for the purpose of selling money orders or checks. [R. 110, lines 10-12.] The fiduciary nature of the agent-princi-

pal relationship does not appear to be open to controversy. See, *e.g.,* California Civil Code Section 2322(3); 1 Witkin, *Summary of California Law,* Agency and Employment, Section 26, page 404 (7th Edition, 1960). Furthermore, it has been stated that,

> "where a person acquires the legal estate and property as the agent of another, or on trust and confidence that he will acquire it for the benefit of another, equity will imply a trust in favor of the latter." 89 *Corpus Juris Secundum,* Trusts, Section 151, page 1068.

The same authority states, at page 1064, that,

> ". . . An agent undertaking any business or performance of any services for another is disabled in equity from dealing with the subject matter of the agency on his own account or for his own benefit, and if he does attempt so to deal in his own name he will be deemed a constructive trustee for his principal."

In view of the foregoing, it is further submitted that the California Legislature, when it enacted the portions of Section 12300.3 of the California Financial Code regarding a trust in favor of licensees such as Security, did not create a "statutory trust", but rather, merely gave statutory recognition to a trust relationship previously in existence.

Section 67(c)(2) of the Bankruptcy Act, upon which Trustee so heavily relies, affects statutory liens ". . . created or recognized by the laws of any state . . ." The

same wording appears in Section 67(b) of the Bankruptcy Act, and in Note 16c, page 185, paragraph 67.20 of *4 Collier, supra,* referring to said language, it is stated:

> "Nothing in the explanations of the legislative draftsmen indicates why it was thought necessary to provide for liens *recognized* as well as *created* by 'the laws of the United States or of any State.' It has been suggested that a 'recognized' lien may very appropriately be one that is not explicitly 'created' by statute, but is deemed to arise by virtue of the rights actually conferred by statute. Hanna, Preferences as Affected by Section 60 (c) and Section 67 (b) of the Bankruptcy Law (1950) 25 Washington Law Review 1, 12, 24 Journal of National Association of Referees 115, 118, citing as an example the lien recognized in *In Re Famous Furniture Co.* (Eastern District New York 1942) 51 Am.B. R. (N.S.) 528, 42 F. Supp. 777." (The lien recognized in the *Famous Furniture Co.* case was that of a city marshal for payment of his statutory fees for levying execution on judgments against a bankrupt recovered within four months prior to the institution of the bankruptcy proceeding.)

By analogy to the foregoing analysis regarding statutory liens, it is submitted that the trust (or trusts) in the case at bar are not trusts "recognized" by state law within the meaning of the relevant sections of the Bankruptcy Act.

The provisions in California Financial Code Section 12300.3 regarding trusts in favor of licensees (Security, herein) were added by the California Legislature in 1963, and to the best of the knowledge of the undersigned there are no reported cases interpreting the 1963 revision. However, the Supreme Court of the State of California has decided a case regarding the trust created by said section in favor of purchasers of checks, drafts, money orders, etc., which trust, it is submitted, is truly a "statutory trust." The Court, in a unanimous decision, said,

> "In terms of trust law, when a check is sold the licensee becomes the trustee, the purchaser becomes the trustor, and the third party payee and holders in due course become the beneficiaries of the *trust*. The Legislature, by Section 12300.3, has authorized both trustor and beneficiaries to enforce the trust, but has denied to general creditors . . . the right to attack or levy upon the *trust* funds. The rules thus laid down by the statute appear fair and equitable . . ." (Emphasis added.) *Bank of America v. Bowden,* 46 Cal. 2d 863, 868, 300 P. 2d 10 (1956).

It is submitted that, in view of the fact that the Supreme Court of California has recognized the trust for the benefit of purchasers created by the subject section of the Financial Code to be a "trust," there can be little doubt that the same Court would hold that the licensees (principals) are beneficiaries under trusts held by their agents as provided by the 1963 amendments.

The California Legislature, in Civil Code Section 2872, has defined the term "lien" so as to specifically exclude a "trust". Furthermore, said Legislature has defined the term "trust" in Sections 2216 and 2217

of the Civil Code. Thus, the fact that the legislature recognizes the distinction between a lien and a trust does not appear open to controversy. Likewise, it may be assumed that Congress, when it refers to "liens", as it does in Section 67(c), means "liens" and not "trusts".

At least since 1940, when the case law cited by *Collier on Bankruptcy* for the proposition that Bankruptcy Courts follow and apply the local law regarding recognition of statutory trusts was made, Congress has been aware of and could have changed the wording of the relevant sections of the Bankruptcy Act to include statutory trusts as well as statutory liens. It is respectfully submitted that, if Section 67(c) should be made applicable to statutory trusts, it is for the legislative rather than the judicial branch of the Federal Government to so decide, and that unless and until said section is amended by Congress to include such trusts, Section 67(c) should be deemed to have no effect thereon.

C. Even if It Is Determined That the Trust Referred to in Financial Code Section 12300.3 in Favor of Security Is a Statutory Trust and That It Should Be Treated in the Same Manner as a Statutory Lien Under Sections 67(c)(2) of the Bankruptcy Act, Security Is Entitled to the Funds in Question Because Security Had Possession Thereof Through Its Agent, Van's.

Section 67(c)(2) of the Bankruptcy Act invalidates ". . . statutory liens . . . on personal property not accompanied by possession . . .", as against the Trustee in Bankruptcy of Van's. The words "accompanied by possession" have been determined to refer primarily to possession at the date of filing of the petition initiating

proceedings under the Bankruptcy Act. *4 Remington on Bankruptcy,* Section 1637.2, page 108 (Revised Edition, 1957) and cases there cited. The same treatise, at page 109, observes

> "It is probably safe to say . . . that only actual possession of personalty, prior to and at the time of filing of the petition initiating proceedings under the Act, held personally by the lienholder *or by an agent,* servant, or officer acting for him and in his behalf, will render either the subordinating or the invalidating provisions of (the 1952 amendment of) Section 67 (c) inapplicable. This statement, however, goes somewhat beyond the decisions to date, none of which construed the section as amended in 1952, and may turn out to be too sweeping." (Emphasis added.)

The word "possession" has been duly recognized to be ambiguous. (4 *Remington, supra,* at p. 109 quoting Judge Frank in *New York v. Hall,* 139 F. 2d 935, 55 A.B.R. (N.S.) (C.A.N.Y., 1944).) Congress, however, has apparently not seen fit to elaborate upon the phrase since 1952. *4 Collier, supra,* paragraph 67.281, at page 312, note 8, in its general analysis of Section 67(c)(2), comments that

> "ordinarily levy, sequistration, or distraint would seem to confer possession on *an agent* of a lienor if not on the lienor himself. Such possession would appear to be sufficient under Section 67-(c) (1) as well as Section 67 (c) (2). . . ." (Emphasis added.)

It is submitted that the possession of the funds in question by Van's as *agent* of Security should be

deemed by this Court to constitute sufficient "possession" by Security to remove the funds from the scope and affect of Section 67(c) of the Bankruptcy Act. Van's was, as to all the world, an agent of Security; the general unsecured creditors of Van's could not and should not have considered the funds held by Van's as such agent to be funds belonging to Van's and, ultimately, funds of the within estate.

2. The Funds in Dispute Were Held by Van's in Trust for Security Regardless and Irrespective of the Trust Referred to in Section 12300.3 of the California Financial Code.

A. Express and Constructive Trusts Were Created by the Execution of the Agency Franchise and Trust Agreement by Van's and Security and Their Acts Subsequent Thereto.

Section 2221 of the California Civil Code provides,

> "Subject to the provisions of Section 852, a voluntary trust is created, as to the trustor and beneficiary, by any words or acts of the trustor, indicating with reasonable certainty: (1) an intention on the part of the trustor to create a trust, and, (2) The subject, purpose, and beneficiary of the trust."

Section 2222 of the Civil Code states,

> "Subject to the provisions of Section 852, a voluntary trust is created, as to the trustee, by any words or acts of his indicating, with reasonable certainty: 1. his acceptance of the trust, or his acknowledgment, made upon sufficient consideration, of its existence; and, 2. the subject, purpose, and beneficiary of the trust." (Section 852 of the Civil Code, regarding trusts relating to real estate is not here relevant.)

The Agency Franchise and Trust Agreement by and between Security and Van's [Ex. "A"; R. 134-135.] expressly provides that "Agent shall hold all (proceeds) in trust for Security entirely separate and apart from other funds in possession of agent until remitted." It appears that the only question raised herein regarding the compliance of said agreement with the above quoted sections of the Civil Code arises regarding the existence of the "subject" of the trust provided for and obviously intended by the parties to the agreement. It is unlikely that any proceeds from the sale of money orders, checks, etc. were in existence on or about November 15, 1962, when the agreement was executed. Trustee alleges that because no such monies were then in existence no trust other than those referred to in Financial Code Section 12300.3 can be found to exist. It is respectfully submitted that said Agency Franchise and Trust Agreement, if not deemed a valid trust agreement or declaration of trust, is at least a contract to settle in trust the proceeds in question which resulted in a valid express trust of said monies no later than upon Van's receipt thereof. It is further submitted that, even if this Honorable Court should determine that no such express trust was created as aforesaid, it is clear that said monies were held by Van's under constructive trust.

It is hereby not disputed that

> "a trust may fail as a present trust because the trust property sought to be made the basis of it is not in existence or because the property which is to be the *res* (although existent) is not owned by the settlor." *1 Bogert, The Law of Trusts and Trustees,* Section 113, page 575 (2nd Edition, 1965).

It has been recognized however, that

> "there may be a *contract* to settle in trust an interest in non-existent subject-matter at a future date when it comes into being and the promisor acquires title to it. Courts of *law* treat transactions which purport to be present transfers or declarations of trust of interests in future things as not amounting to contracts and as void. *Equity* has taken a different attitude toward present efforts in return for consideration to create present trusts in future subject-matter. It has reasoned that such a transaction could not have been intended to operate as a present act of trust creation because of the inherent impossibility of such an effect. The parties must therefore have expected the only other possible presently operative result, namely, that there should arise a contract to create a trust in the future. The parties are not to be deemed to have intended a futile act. Viewed as a contract to create a trust in the future, when the subject-matter came into being and was acquired, equity found that in the common law there was no remedy at all. The law did not recognize the existence of such a contract. There was more than inadequacy of remedy; there was total absence of remedy at law. Equity therefore took the position that it would give specific performance or its equivalent. When the subject matter came into existence and into the hands of the intended settlor, it would at once be deemed to be held in trust, without any act of appropriation by the intending settlor, assuming that there was consideration for the transaction. In other words, if one purported for value to make a present

> declaration of trust of corporate shares which he did not own, or which did not then have existence, and later the declarant gained title to shares of the kind described, equity would treat the trust as taking effect on the acquisition of the shares and an equitable interest as then passing to the beneficiary." *1 Bogert, supra,* Section 113, pages 575-576.

Trustee asserts at page 27 of his Opening Brief that the case of *Balian v. Balian's Market,* 48 Cal. App. 2d 150 (1941), supports the proposition that because the subject of the intended trust was not in existence at the time the agreement was executed, the trust must fail. The facts before the Court in the *Balian* case were quite complex. Plaintiffs alleged an oral agreement to place all earnings and property acquired by the members of the Balian family in a common fund or trust; the Court found that only one of the several children involved was of age at the time of the alleged agreement; the agreement contained no provisions as to the matter in which the father, as trustee, was to handle any property acquired, nor any restrictions upon his disposing of all or any part thereof; and that the agreement merely provided for distribution to the children then surviving upon the death of the father. The Court noted that there was no property or *res* upon which the alleged trust could operate. *Balian v. Balian's Market, supra,* pages 155-156. The Court went on to state:

> "We think the terms of the trust agreement are altogether too uncertain and tenuous to have warranted the trial court impressing a trust on any of the property. The agreement of trust falls far short of measuring up to the rule laid down in *Lefrooth v. Prentice,* 202 Cal. 215 (259 Pac. 947). There it

is said (p. 227) that an express trust must be 'reasonably certain in its material terms; and this requisite of certainty includes the *subject matter* or property embraced within the trust, the beneficiaries or persons in whose behalf it is created, the nature and quantity of interest they are to have and the manner in which the trust is to be performed.' (Italics the Court's) A most casual reading of the terms of the oral trust which we have outlined above discloses a complete failure to meet any of the requirements of the rule laid down in the Lefrooth case.

"Moreover, to the creation of the trust, a trust res or subject matter is a *sine qua non. . . .*' 'In order for trusts to exist there must be an estate to vest in the trustee, and the property must be clearly and definitely pointed out.' (*In Re Lamb,* 61 Cal. App. 321 (215 Pac. 109).) Here there was no property in the hands of the alleged trustee. The cash which the father had, totaling $160.00 had already been turned over to (the son). It never became a part of any trust estate, but instead was consumed in living expenses. Accordingly, we think that for want of a trust res, and because of the indefiniteness of the terms of the alleged trust agreement, the agreement was not enforceable. . . ." *Balian v. Balian's Market, supra,* page 156.

It is submitted that the Court in the *Balian* case found the uncertainty surrounding the alleged trust agreement, the designation of the subject or res, and the entire circumstances of the transaction and parties in question to warrant a refusal by the lower court to find

the existence of a trust. It is further submitted that said Court did not hold that the trust failed because no subject or *res* existed at the outset.

In the case of *Molera v. Cooper,* 173 Cal. 259 (1916) the California Supreme Court stated, at page 262, that

> "A mere promise to obtain money and thereupon hold it in trust does not create a trust *until it is at least so far executed that the money has been obtained in accordance with the promise.*" (Emphasis added.)

In the *Molera* case, plaintiff sued upon a written promissory note for $1,000.00 which had been given by defendant to a decedent whose estate plaintiff represented. In defense, defendant alleged that the note had been extinguished by an oral agreement between her and the decedent under which defendant had agreed to hold the sum of $1,000.00, together with interest from the date of the note, in trust for other persons. The Court noted, at page 261, that

> "It is not alleged that the defendant then had in her possession or under her control the money owing upon said note, or that she has at any time since procured the same and devoted the same to said trust, or that she was then or has been since, solvent and able to do so. One ground of (plaintiff's ultimately sustained demurrer) was that the answer was uncertain in that it cannot be ascertained therefrom what particular monies the defendant held in trust as set forth therein, or whether or not any specific amount of money was held in trust. In view of this ground . . . the allegation that the defendant has ever since April 10, 1911

'held and does now hold said amount of money upon the trust proposed' is not to be construed as meaning that the defendant then had the money in hand, or has at any time since then possessed the same and devoted it to said trust. . . . *The case must be considered upon the theory that all (defendant) did in regard to the creation of the trust was to agree that she would thenceforth hold the sum of money specified in the note in trust for the (beneficiaries).* . . . It is clear that no trust was created by the aforesaid arrangement. There *never* was any property in existence which could be the subject of the trust." (Emphasis added.)

The Court went on to make the statement initially quoted. It is submitted that, had the defendant been able to show that she subsequently acquired the money to be held in trust, the Supreme Court would have found that a trust existed under the facts. Otherwise, the italicized portion of the initial quotation from the case could have and most certainly would have been deleted from the opinion.

It is not now, nor has it ever been the position of the undersigned that a trust can exist without a subject or *res*. Rather, it is submitted that the monies in dispute herein became the subject or *res* of an express trust upon their acquisition by Van's. As noted in *89 Corpus Juris Secundum,* Trusts, Section 24, page 741,

> "It has been held . . . that a declaration of trust of property executed before the acquisition of property, does not fail for want of the requisite subject matter, but that the instrument takes full effect when the subsequent title vests in the declarant".

It is submitted that the Supreme Court of California, in the *Molera* case, expressly recognized said rule, and the sparseness of California cases on point attests to its general recognition.

Section 2217 of the California Civil Code provides "An involuntary trust is one which is created by operation of law." Section 2223 of the Civil Code states that "One who wrongfully detains a thing is an involuntary trustee thereof, for the benefit of the owner.", and Section 2224 provides that "One who gains a thing by fraud, accident mistake, undue influence, the violation of a trust, or other wrongful act, is, unless he has some other and better right thereto, an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it." Even if no express trust is found herein by this Honorable Court, it appears clear that Van's, as agent of Security, acted in violation of its agency agreement by its failure to hold the proceeds separate and apart from other funds in its possession. [R. 110, lines 24-31.] 4 Witkin, *Summary of California Law,* Trusts, Section 87, page 2970, indicates that the trusts provided for in Sections 2223 and 2224 of the Civil Code are what are commonly known as "constructive trusts". Furthermore, there is ample authority to the effect that an agent's breach of his duties will prompt the Court to impose such a trust. *4 Witkin, supra,* Section 90, page 2973, and cases there cited; *49 Cal. Jur.* 2d, Trusts, Section 386, page 232, Note 18. Even in the absence of a valid trust under Financial Code Section 12300.3 and an express trust created by and between Van's and Security, it is therefore respectfully submitted that the facts in the case at bar warrant and require the imposition of a constructive trust herein.

3. It Is Not Disputed That Security Must Trace the Trust Subject or Res, and Bumb, as Trustee of the Estate of Security, Has Done so to the Extent Required by California Law.

The parties to the within proceeding have agreed that the funds held by the Association in the sum of $2,014.99 represent monies which were on deposit in Van's bank account prior to October 15, 1963, which represented money orders sold by Van's for Security. [R. 110, lines 23-27.] It is thus submitted that trust funds in the sum of $2,014.99 (whether they be deemed the subject of a statutory, express, or constructive trust) have been fully and adequately traced and that Bumb, as Trustee of the Estate of Security, is clearly entitled thereto.

As to the balance of $1,094.17, Section 12300.3 of the California Financial Code provides, in part,

> "If . . . an agent . . . shall commingle (receipts heretofore discussed) with those of his own, all assets of such agent shall be impressed with a trust in favor of . . . the licensee in an amount equal to the aggregate funds received or which should have been received by the agent. . . . Such trust shall continue until an amount equal to said funds is separated from those of the agent and transmitted to the licensee or deposited in the trust account of licensee. . . ."

It is respectfully submitted that this portion of Section 12300.3 provides a remedy in the nature of or analogous to a resulting or constructive trust upon the assets of a commingling agent. It alleviates the difficulties which might otherwise be experienced in attempting to trace wrongfully commingled funds, and to this extent

may be said to constitute an important change in the trust law of the State of California. Even if the quoted language be deemed to create a statutory trust, it is submitted that the creation thereof is fully within the authority of the California Legislature; that it is a *trust,* not a lien, and should not be treated as the latter under the Bankruptcy Act; and that the $1,094.17 which is the *res* thereof was in the possession of Van's as agent of Security, and thus within the possession of Security within the meaning of Section 67(c)(2) of the Bankruptcy Act, all for the same reasons as previously set forth at length above.

4. The Funds in Dispute Are Trust Funds and Are Not Within the Scope of Section 64 of the Bankruptcy Act.

As recognized in *4 Collier, supra,* paragraph 70.25, page 1202, *et seq.*

> "The Rule is elementary that a trustee in bankruptcy . . . succeeds only to the title and rights in the property that the debtor possessed, but armed, of course, with the special rights and powers conferred upon the trustee by the Act itself. Therefore, where the bankrupt or debtor was in the possession of property impressed with a trust which is valid under the terms of the Act, the bankruptcy or reorganization trustee can only hold such property subject to the outstanding interest of the beneficiaries. When it appears that the bankrupt was only a trustee and had no beneficial interest in or claim against the property, even though he held the legal title thereto which passed to the bankruptcy trustee, the Court should turn the property over to its true owners where possible."

As further stated in the treatise, "The system of priorities established by Section 64 for the distribution of the estate to unsecured creditors does not govern or control the payment or delivery of the trust property." *4 Collier, supra,* paragraph 70.25, page 1204; and see *3 Remington, supra,* Section 1212 *et seq.,* page 48 *et seq.*

In view of the above, it is submitted that Section 64 of the Bankruptcy Act has no application herein because the funds in question are trust funds as aforesaid.

Conclusion.

For the foregoing reasons, the Order of the District Court should be affirmed and the funds which are the subject of the within appeal should be ordered turned over to Bumb as Trustee of the Estate of Security.

Sulmeyer & Kupetz,
By Robert W. Alberts,
Attorneys for Appellee A. J. Bumb.

Certificate.

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the 9th Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Robert W. Alberts

No. 20,094

United States Court of Appeals

For the Ninth Circuit

EASTLAND CONSTRUCTION CO., INC., *Appellant*, vs. KEASBEY AND MATTISON COMPANY, *Appellee*.	

APPELLANT'S REPLY BRIEF

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ERNAU-WALSH PRINTING CO., SAN FRANCISCO

Table of Authorities Cited

No. 20,094

United States Court of Appeals

For the Ninth Circuit

EASTLAND CONSTRUCTION CO., INC., *Appellant,* vs. KEASBEY AND MATTISON COMPANY, *Appellee.*	

APPELLANT'S REPLY BRIEF

Relying in the final analysis, upon a hypertechnical interpretation of the so-called "present tense" language of Section 12 of the Clayton Act (15 U.S.C. 22), most of appellee's other arguments in favor of affirmance are irrelevant. Appellee spends a considerable amount of time pointing out that "it was not an inhabitant of" or "found within" or "not in fact transacting business in" the Northern District of California at the time suit was brought. All of these facts counsel for appellant conceded in open Court in argument before the District Judge and simply are not in issue here. Moreover, the almost passionate rehash of the criminal and civil litigation with the Government is beside the point. Accusations that the Government engaged in a process of "almost continual harassment" and that the litigation instituted by the

grand jury and/or Department of Justice was "spurious", tend only to obscure the importance of the legal issue presented for determination by this Court.[1]

In short, appellee's argument boils down to this: That it has been acquitted of criminal charges levied by the Government and has been dismissed from the companion civil suit on the ground of mootness. This having been accomplished, K & M should not be subjected to further litigation, particularly in a forum where it does not maintain the headquarters for its corporate shell. This argument is neither appealing when approached from the standpoint of reason nor is it consistent with the overall design of Congress in encouraging enforcement of the antitrust laws by means of private litigation.

Appellee has chosen to ignore the logical argument that Congress could not have intended, on the one hand, to encourage private litigants to await the outcome of Government litigation and penalize potential antitrust plaintiffs if they wait by requiring these plaintiffs (usually small companies) to chase the alleged corporate violators across the country in order to prosecute their claims. Indeed, appellee makes no meaningful argument

[1]An examination of the record in the criminal case hardly supports the assertions that the Government engaged in harassment or that the litigation was spurious. Much of the Government's strongest evidence was excluded by the District Court on asserted constitutional grounds which could not possibly affect the admissibility of the evidence in this civil proceeding. Needless to point out the burden of proof standards are wholly different and the District Judge's comments in the criminal case that the Government had not even met the burden of proof test in a civil case must be read in the light of the fact that substantial and extremely important segments of the Government's proposed proof were never admitted into evidence.

that the procedural statutes governing the conduct of treble damage litigation must be read as a harmonizing and interlacing text rather than literally and individually.

There is no question but that the tolling provisions of Section 5 of the Clayton Act (15 U.S.C. 16(b)) deal with the time when an antitrust case may be instituted. But, in extending that time for the mutual benefit of prospective plaintiffs and actual defendants alike, Congress could not have intended to make prospective plaintiffs give up their right, granted to them expressly, to commence the litigation at a place where the alleged unlawful activities adversely affected the plaintiff—a forum in which defendant was transacting business at the time of the alleged unlawful activities. And appellee is unable to point to a single case in any Court of Appeals or in the Supreme Court which approves its view that a literal and isolated interpretation of Section 12 of the Clayton Act (15 U.S.C. 22) is required.

Characterizing the "hit and run" language of *U.S. v. Scophony,* 333 U.S. 795 (1958) as "dictum", appellee implicitly concedes that, despite the "present tense" language of Section 12 of the Clayton Act, the Supreme Court would not tolerate a situation in which the defendant "retreated" or "hit and ran". But appellee argues this is not such a case. We submit that neither the Supreme Court in *Scophony* nor Congress ever contemplated a rule which makes venue turn upon an exhaustive fact analysis of the reason *why* a defendant has retreated from the forum in which an alleged injury occurs. Nowhere have the Supreme Court or the Congress exhibited any concern with the reasons for which a defendant

retreats. What Congress and the Supreme Court were concerned with was the fact of retreat itself. Retreat, for any reason (whether to avoid suit or for legitimate business purposes), has the necessary effect of defeating or delaying the plaintiff's right to prosecute the action.

Moreover, appellee's argument that it should not be required to defend this suit some 3000 miles from its place of business is precisely the argument which the Supreme Court rejected in *Scophony.* For in that case the Supreme Court recognized that a plaintiff of small means would be subjected to the "often insuperable obstacle of resorting to distant forums for redress of wrongs done in their places of business or residence". And in *Scophony* the Supreme Court reiterated that it was unwilling to construe Section 12 in a manner "to bring back the evils it abolished . . . and thus to defeat its policy . . . so as to make another amendment necessary". (333 U.S. 795 at 808, 817.)

The Supreme Court has spoken. In those instances where a burden is involved in commencing or defending antitrust litigation, it is clear that the Court has elected that the defendant—usually a large corporation whose activities ordinarily are much wider in scope than those of the normally localized plaintiff—must bear that burden.

Appellee's argument that reversal of the decision below would frustrate the purposes of the Clayton Act and would "penalize Keasbey and Mattison's decision to liquidate . . ." is but another impassioned plea which assumes that there is "penalty" involved in defending a suit at a place where it clearly could have been brought but for K & M's "retreat". Indeed, there is no penalty

involved here except to plaintiff. The decision below effectively precludes this plaintiff from chasing appellee across the country in order to seek restitution for the overcharges alleged. It thus assists in insulating this defendant from potential civil liability and grants to appellee a privilege which Congress could not conceivably have intended in drafting the procedural framework dealing with the institution and conduct of treble damage litigation.

Appellee has feebly attempted to distinguish *Ross-Bart Port Theatre v. Eagle Lion Films*, 140 F.Supp. 401 (E.D., Va. 1954). Asserting that *Ross-Bart* dealt with the issue of service of process and not venue, defendant cites, out of context, a single sentence at page 403 of the opinion, intending to leave the impression that the subject of improper venue was not at all at issue. But the opinion read in context leaves no doubt that venue was the *key* question presented by the moving party. In the second sentence of the opinion, the District Judge recites that defendant "has moved to quash the process and dismiss the action for lack of venue". Further, in the first paragraph of the opinion, the District Judge notes that

> "the only ground of the motion now is that the defendant was not at the time of the execution of the summons an inhabitant or resident of the Eastern District of Virginia, was not found there, had no agent there, was not transacting business therein and *hence was not subject to suit in this Court and has not been brought here by such service.*" (Emphasis added.)

It is quite clear that *Ross-Bart* stands for the proposition that a defendant need not be transacting business at

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No. 20084

In the

United States Court of Appeals

for the Ninth Circuit

EASTLAND CONSTRUCTION CO., INC.,
Appellant,

vs.

KEASBEY AND MATTISON COMPANY,
Appellee.

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SUBJECT INDEX

TABLE OF AUTHORITIES CITED

No. 20,084

In the

United States Court of Appeals

for the Ninth Circuit

EASTLAND CONSTRUCTION CO., INC.,
Appellant,

vs.

KEASBEY AND MATTISON COMPANY,
Appellee.

Brief for Appellee

I.

JURISDICTION

Judge Zirpoli in the court below dismissed the action as to defendant K & M for improper venue under § 12 of the Clayton Act, 15 U.S.C. 22, in that it was conceded by plaintiff-appellant that for almost 2½ years prior to the time this action was brought, the defendant had not transacted business in California.

Since the judgment entered on April 2, 1965 was final as to K & M, we concede that Your Honorable Court has jurisdiction to hear this appeal.

II.

STATUTE INVOLVED

15 U.S.C. 22 provides:

> "That any suit, action, or proceeding under the anti-trust laws against a corporation may be brought not only in the judicial district whereof it is an inhabitant, but also in any judicial district wherein it may be found or transacts business; and all process in such cases may be served in the district of which it is an inhabitant, or wherever it may be found."

III.

STATEMENT OF THE CASE

Because the instant complaint mirrors a federal indictment brought against Keasbey & Mattison Co. in June of 1962 and a parallel federal civil complaint against Keasbey & Mattison Co. filed July 25, 1962, the outcome of these federal actions and certain findings therein are relevant to this motion to dismiss.

On May 21, 1964, a Federal Jury in Philadelphia after a trial lasting four-and-one-half months brought in a verdict of not guilty in a criminal anti-trust case, (Criminal No. 21118 R. p. 52) thereby exonerating the defendant Keasbey & Mattison Co. (hereafter referred to as K & M) and its co-defendant, Johns-Manville Corporation, of all charges of alleged violations of the anti-trust laws in connection with the manufacture and sale of asbestos-cement pipe.

On December 22, 1964, the District Court Judge who heard the criminal case, granted summary judgment for K & M in the Government companion civil case (Civil No. 31791)[1] on the ground of mootness, inasmuch as K & M

1. This ended the civil suit against K & M. Insofar as plaintiff's statement that "A companion civil case is now pending," (plaintiff's brief, footnote 1 at p. 4) applies to K & M, it is in error.

had sold its asbestos-cement pipe assets and gone out of business. See *U.S. v. Johns-Manville, et al.*, 237 F. Supp. 885 (E.D. Pa., 1964); opinion appears in Record at pages 55 through 72. In his opinion, the District Court Judge made it clear that even applying the "fair preponderance" burden of proof test for a civil case, that the Government had failed to prove its charges of conspiracy and further that the K & M decision to go out of business and sell the pipe business "was dictated by valid and bona fide business reasons" (R. p. 59); and was not done to avoid the impact of the anti-trust laws. (R. p. 70)

Thus, came to an end an extraordinary chapter of almost continuous harassment of the defendant by the F.B.I., the Justice Department, various Government counsel and several Grand Juries over a period of almost nine years. (R. p. 70)

The present Summons and Complaint has been brought against K & M by a plaintiff, who has never bought an inch of pipe from defendant and who has never had any business dealings with the defendant. (R. p. 2) It calls upon the defendant to retain counsel and appear to defend, in a jurisdiction some 3,000 miles away from its home, a groundless claim based upon almost a verbatim copy of the Indictment and complaint in the two cases where defendant has already been completely exonerated.

In an effort to head off any further burdensome expense, the defendant, K & M moved the District Court below to strike off the service, or in the alternative, to dismiss the action because of improper venue, to grant summary judgment for the defendant, and to grant a stay of all discovery proceedings on the issue of the defendant's alleged liability to plaintiff (R. p. 154) pending disposition of these motions.

The court below found that venue was improper and by order of April 2nd, 1965, judgment was entered for defendant K & M.

Plaintiff appealed. This brief is filed by defendant-appellee in opposition to plaintiff-appellant's position.

IV.

QUESTION PRESENTED

In determining proper venue under 15 U.S.C. 22 in a private anti-trust action for damages, must not the operative facts of defendant's business activities within a judicial district be determined as of the date the court's jurisdiction attaches and not as of the date when the alleged cause of action arose?

V.

SUMMARY OF ARGUMENT

1.) 15 U.S.C. 22, couched as it is in the present, not past tense, means exactly what it says—i.e. that the operative facts as to business activity which determine where a private treble damage action under the anti-trust laws may be brought, are to be determined as of the date the action is brought—and not as of the date when the alleged cause of action arose. *Schreiber v. Loews, Inc.,* 147 F. Supp. 319 (U.S.D.C., W.D. Mich. S.D. 1957); *Newmark v. Abeel,* (D.C. N.Y. 1952) CCH 1952 Trade Cases ¶ 67,268.

2.) The 1955 amendment to Section 5 of the Clayton Act, now 15 U.S.C. 16 (b), which provides for tolling of the statute of limitations during pendency of the Government's civil or criminal action, has no relevance or bearing whatsoever on *the place* where a private treble damage action may be brought. This amendment manifests no intent of the Congress to amend or broaden the applicable

venue statutes. It applies to *when,* and not *where,* such an action may be brought.

3.) There is nothing in the holding or the opinion in *U. S. v. Scophony Corporation,* 333 U.S. 795, 68 S. Ct. 855 (1948), that supports plaintiff—appellant's position on venue—since the Court there specifically used the present tense test in measuring the defendant's activities for venue purposes.

Furthermore, the Supreme Court's reference at page 808 to a foreign corporation's "hit and run" activities has no bearing on the instant case, where, as here, there was a bona fide termination of *all* business activities, wherever previously conducted; and, as pointed out by Judge Zirpoli, the defendant "K & M ceased to do business in California and has not done any business in this state . . . for two years, five months and 18 days" prior to the filing of suit in this case. (R. p. 149)

VI.

ARGUMENT

A. Introduction.

By way of introduction, may we respectfully call to your Honorable Court's attention the decision of District Court Judge Van Dusen in granting summary judgment for K & M in the Government civil case *U. S. v. Johns-Manville et al.,* 237 F. Supp. 885 (E.D. Pa., 1964). This Opinion, together with the supporting affidavits on which he relied in part, is attached as Exhibit E to the K & M Motion papers (R. 55 through 149). It gives a much clearer picture of some of the more basic facts than we could or should attempt to set forth in this Memorandum Brief.

Suffice it to say that on or after June 1, 1962, K & M, in an arm's length transaction and unrelated to the spurious

anti-trust charges levelled against it, sold all of its asbestos pipe equipment and assets in exchange for shares of stock in the acquiring corporation, Certain-teed Products Corporation. K & M then liquidated its cash and remaining assets, i.e. the shares of Certain-teed stock, by making distributions to its shareholders. On and after June 1, 1962, Certain-teed took over some of K & M's employees, but not its principal executive officers, and began to operate the business it had purchased from K & M.

B. Defendant's Activities Do Not Meet Any of the Tests for Venue Under 15 U.S.C. 22.

Plaintiff seeks to establish venue under § 12 of the Clayton Act, 15 U.S.C. 22[2], which reads as follows:

> "Any suit, action, or proceeding under the anti-trust laws against a corporation may be brought not only in the judicial district whereof it is an inhabitant but also in any district wherein it may be found or transacts business; and all process in such cases may be served in the district of which it is an inhabitant, or wherever it may be found. Oct. 15, 1914, c. 323, § 12, 38 Stat. 736."

What then are the legal tests to be applied in determining whether, at the time the action was brought[3], K & M was:

(1) an inhabitant of,

(2) found in, or

(3) transacting business in

the Federal Judicial Northern District of California?

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2. If there is no venue under 15 U.S.C. 22, a fortiori, venue would fail under § 4 of the Clayton Act—15 U.S.C. 15.

3. The jurisdiction facts which control the procedural questions of venue are determined as of the time suit was brought. See *Schreiber v. Loews, Inc.*, 147 F. Supp. 309 (U.S.D.C. Michigan, S.D. 1957).

1. K & M WAS NOT "AN INHABITANT OF" THE FEDERAL JUDICIAL NORTHERN DISTRICT OF CALIFORNIA.

K & M was clearly not, at the time the instant action was brought, "an inhabitant of" the Federal Judicial Northern District of California. The term "inhabitant" has been held to mean the state of incorporation or where the corporation has its principal place of business. See *U.S. v. Scophony Corp.,* 333 U.S. 795 at 809, footnote 20.

As appears from the affidavit of C. B. Brown, the present President of K & M (See Exhibit F attached to the Motion, R. p. 13), K & M, at the time this suit was commenced, had no place of business or office within the State of California, and had never been incorporated in the State of California. K & M is and always has been incorporated solely under the laws of the Commonwealth of Pennsylvania. Thus, for venue purposes, it is an "inhabitant" only of Pennsylvania, and may only be sued within the proper judicial district located within that State.

2. K & M WAS NOT "FOUND WITHIN" THE FEDERAL JUDICIAL NORTHERN DISTRICT OF CALIFORNIA.

As pointed out in the *Eastman* case, infra, the term "found in" means being present within a state through the presence of officers or agents carrying on the corporation's business. See *Eastman Co. v. Southern Photo,* 273 U.S. 359 at 371.

Here again, the affidavit of Mr. Brown, and the Opinion of Judge Van Dusen (Ex. E, R. p. 55) with the accompanying affidavits attached to that Opinion (R. p. 73-149), make it clear that since June 1, 1962, K & M has done no business whatsoever in California or elsewhere; has sold all of its assets; has no employees; and in the words of Mr. Brown "is nothing more than a paper shell awaiting final tax clearance from the Commonwealth of Pennsylvania, following

receipt of which it will file with the Secretary of the Commonwealth of Pennsylvania, Articles of Dissolution which will terminate its corporate existence." (See Brown affidavit, Ex. F ¶ 1 R. p. 13)

3. K&M WAS NOT "TRANSACTING BUSINESS IN" THE FEDERAL JUDICIAL NORTHERN DISTRICT OF CALIFORNIA.

As pointed out in *U.S. v. Scophony Corp.*, the term "transacting business" as used in § 12 of the Clayton Act, was intended to liberalize and broaden the earlier concepts of venue—so that today the test for venue under this Section now becomes "the practical everyday business or commercial concept of doing or carrying on business of any substantial character". See 333 U.S. 795 at 807.

Here again, it is clear that under this test, K & M was not transacting business in California at, or for some time prior to the instant suit having been started, because on and after June 1, 1962, it transacted no business anywhere. Furthermore, as appears from Mr. Brown's affidavit, at no time has the defendant, K & M ever sold any pipe to the plaintiff or had any business transactions with it in California or elsewhere.

C. The Test of Business Activities Under 15 U.S.C. 22 Is Phrased in the Present—Not the Past Tense. Thus the Business Activities of a Defendant Are Measured as of the Date When the Action Is Begun.

While the question of venue is admittedly a procedural one, and might be viewed by some as a technical defense, we believe that this defense has special merit and application to the case at bar. The very concept of venue contemplates that there should, in all fairness, be certain restrictions on the extent to which a party may be sued in various parts of this large country in which we live. As was said

in *Jacobson v. Indianapolis Power and Light Co.*, 163 F. Supp. 218 (N.D. Ind. 1958):

> "Historically the privilege of venue has been allowed so that suits will be brought in forums having a logical connection with the parties to the litigation. Generally venue relates to the convenience of the parties and affords a defendant some protection against the threat of being forced to defend an action at a place far removed from his residence." (at 223)

Here, a plaintiff, who has never bought any products from the defendant or never had any business dealings with it, has chosen to bring an action under an Act of Congress which spells out exactly the terms and conditions on how and where such an action may be brought.

The plaintiff has not followed the mandate of Congress in choosing the place of suit—at least as regards the defendant, K & M. Plaintiff, instead, has chosen a forum which may be convenient for his counsel but one which would work a great hardship on the defendant. Furthermore, none of the cases plaintiff has cited as supporting his view of Congressional policy deal with venue. (Plaintiff's brief p. 7f.) They seem rather to deal with matters having far different policy considerations: *Flintkote Company v. Lysfjord,* 246 F. 2d 368, 398 (9th Circuit, 1957) deals with joint and several-liability for punitive damages; *Olympic Refining Co. v. Carter,* 332 F. 2d 260, 264 (9th Circuit, 1964) with discovery; *Lawlor v. National Screen Service,* 349 U.S. 322 (1955) with res judicata effect of a previous action with different defendants; *Bruce's Juices, Inc. v. American Can Co.,* 330 U.S. 743 (1947), with the legality of a contract under the Robinson-Patman Act.

The defendant, K & M, is now in its final steps of dissolution, said steps having been taken in its home state—the state of its incorporation and where it formerly had

its principal place of business. This is where its records and its counsel are. Parenthetically, the Commonwealth of Pennsylvania would also seem to be the most convenient forum if the plaintiff had a valid cause of action—which we respectfully submit he does not—because this is where the Grand Jury sat and where most all of the documents and records which were used by the Government in its case remain and where many of the witnesses who testified reside. Suffice it to say that the only remaining vestiges of K & M's corporate existence remain in and only within the Federal Judicial District for Eastern Pennsylvania.

Considering the tremendous burden and expense in connection with anti-trust matters to which the defendant, K & M, has been subjected almost continuously since the Fall of 1956, (see footnote 12 at page 18, Judge Van Dusen's Opinion—Exhibit E, R. p. 72) and its subsequent complete vindication, we submit that it would be manifestly unfair to now require this defendant to incur the additional expense and problems of defending a lawsuit so many thousands of miles away from home base.

Had the Congress felt in its wisdom that a corporation, having once transacted business within a state, should always remain subject to suit in a Federal Court in that state, it could have so provided. As was stated in *Lindstrom v. Commissioner of Internal Revenue*, 149 F. 2d 344 (9th Cir. 1945) at page 346: "The will of Congress has been plainly expressed in language that does not permit or require a strained or immaterial interpretation. The words of the statute may not be extended beyond their plain popular meaning."

In Toulmin's Anti-Trust Laws, Vol. VI, Section 4.14 it is stated:

> "The defendant must be, at the time process is issued transacting business in the district. If it had merely

transacted business in the past that is not enough to authorize the service of process."

In this connection see *Schreiber v. Loews, Inc.*, 147 F. Supp. 319 (U.S.D.C. W.D. Michigan S.D. 1957) where District Judge Kent pointed out that the venue statute with which we are concerned is phrased in the *present*, not the past tense.

> "In effect the plaintiffs claim that the statutes applicable to this situation should be interpreted to read 'a corporation may be sued in any judicial district in which it is incorporated or licensed to do business or is doing business *or has done business in such a manner as to create a claimed cause of action.'* However, the provisions of the venue section of the Clayton Act, Title 15 U.S.C.A. § 22, and the provisions of the general venue statute Title 28 U.S.C.A. § 1391 (c) are phrased in the present tense, and do not give any right except as a corporation may be found actually present in or doing business in a state." (at 324)

For a case almost on all fours with the case at bar, see *Newmark v. Abeel,* (D.C. S.D. N.Y. 1952) CCH 1952 Trade Cases ¶ 67,268. This was an action brought in the Southern District of New York against a New Jersey corporation that had been dissolved about two years before suit was started. The defendant corporation was served at its registered office in New Jersey.

To support venue under 15 U.S.C. § 12, the plaintiff offered affidavits relating to alleged activities within the Southern District of New York several years before suit was started. In granting defendants motion to dismiss for lack of venue, Judge Weinfeld stated:

> "Whether the defendants are 'found' or 'transacting business' in this district is in sharp dispute. The affidavits submitted by plaintiff relate to activities of the

defendants during 1949 and earlier years. On this motion the issue is whether the defendants were 'found' or 'transacting business' *here at the time of service of process.*" (at 67475) (emphasis added)

The most recent case to apply the present tense test of venue is *Snyder v. Eastern Auto Distributors, Inc.* U.S.D.C. W.D.S.C. (1965), 1965 Trade Cases ¶ 71,448. In this case, under a venue statute couched in the same present-tense language as 15 U.S.C. 22,[4] the defendant, attacking venue, had withdrawn the franchise of his automobile dealer less than two months before action was brought, and was, when the action was brought, still engaged in supervising the return of automobiles.

In holding venue not proper since the defendant did not reside or was not found or did not have an agent in South Carolina, the court stated:

> "The question of whether a corporation is 'doing business' or 'is found' within a state must be determined as of the time the action was filed, Cf. *Prolex (sic) Steel Corp. v. Luria Brothers and Co.,* 225 F. Supp. 412." (at 80,963)

It then found that even if the district sales manager were considered as the corporation's agent, "his visit was not part of a systematic and continuous activity".

Thus, in a situation similar to our own, as to facts and venue statute, the court found that after less than two months of cessation of doing business, venue was improper. Quoting from *Prolex,* infra, p. 413, the court said:

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4. 15 U.S.C. 1222 reads:

"An automobile dealer may bring suit against any automobile manufacturer engaged in commerce, in any district court of the United States in the district in which said manufacturer resides, or is found, or has an agent . . ."

> "It is well settled that venue and jurisdiction are determined by the facts as they exist at the time the action is filed." (at page 80,965)

We submit, the statute here involved is clear and unambiguous. It is couched in the present tense and the only possible interpretation that can be given to this clear language is that the Congress intended that the question of venue be measured by the facts existing at the time the court's jurisdiction is invoked and the defendant is required to appear and defend.

D. The 1955 Amendment to Section 5 of the Clayton Act (15 U.S.C. 16 b) Providing for Tolling of the Statute of Limitations During Pendency of the Government's Civil or Criminal Actions, Has No Relevance or Bearing Whatsoever on Venue Requirements of the Same Act.

Plaintiff devotes much attention to a possible relationship between the statute of limitations amendment provisions and venue provisions. These provisions have very different bases.

The statute of limitations concerns *when* an action may be brought. It bars action when claims become stale and evidence uncertain. The extension of the tolling period of the statute was to both allow the plaintiff time to study the government's case (which cannot benefit plaintiff here since K & M was acquitted) and to prevent harassment of the defendant with multitudinous suits.

However, venue is concerned with *where* an action may be brought. It is based upon the connection between the forum and the parties to the litigation, and in great measure is designed to protect the defendant from harassment involving defense of an action far from its home. See *Jacobson v. Indianapolis Power and Light Company,* supra.

Plaintiff argues that the Congress in amending and broadening the Statute of Limitations provisions, manifested an intent to benefit treble damage plaintiffs; and that it would frustrate the intent of Congress if venue provisions currently in effect were interpreted to make the bringing of an action by Plaintiff more difficult. This argument, we suggest, is a complete non sequitur. For if that was the intent of Congress why would it not also have changed the venue provisions? Because Congress had seen fit to liberalize one provision of the statute (dealing with *when* an action must be brought) does not mean that another provision of the statute (dealing with *where* such a suit may be brought) and having entirely different policy bases, should be interpreted contrary to the clear language of the statute as worded.

E. The Case of U. S. v. Scophony Corp. 333 U.S. 795, Does Not Support Appellant's Contention That Venue May Be Based Upon Past Business Activities.

The U. S. Supreme Court decision in *U.S. v. Scophony* is no authority for plaintiff's proposition advanced at pages 12-17 of its brief that the test of venue is measured as of the date the alleged wrongful act occurred.

In Scophony, the court had to determine whether the American anti-trust laws could reach a British corporation that had, and was at the time suit was started and processed served, engaged in a number of activities in the district in which venue was founded.

In the course of holding that the sum total of defendant's activities constituted "transacting business" in the ordinary lay sense, the court made clear, as appears in the underlined portions below, that venue is tested by the defendant's activities at the time of suit and not the past activities; and

furthermore totally rejected Scophony's contention that its activities were those of a corporation attempting to disengage and cease doing business:

> "To say that on the facts presented Scophony transacted no business 'of any substantial character' there *during the period covered by institution of the suit and the times of serving process* would be to disregard the practical, non-technical, business standard supplied by 'or transacts business' in the venue provision. . . .
>
> "Scophony's operations in New York were a continuous course of business before and throughout the period in question here." (at 810) (Emphasis added)

further,

> "Those efforts were not cessation of engaging in business. They were directed entirely to ward off that fate. Their object was not to liquidate, it was to resuscitate the business of Scophony and, as in all previous stages, put it on a normal course again. In doing all this, Scophony was engaging in business constantly and continuously not retiring from it or interrupting it. (citing cases) The interruptions were only in particular phases of its authorized adventure, not in the continuity, intensity or totality of the adventure itself." (at 816)

and again

> "We think that Scophony not only was 'transacting business' of a substantial character in the New York district *at the times of service, so as to establish venue there,* but also on the sum of the facts regarding its activities was 'found' there within the meaning of the service-of-process clause of § 12." (at 818) (Emphasis added)

In the course of its opinion, the Court at page 808 made a statement which is clearly dictum, to the effect that no longer could a foreign corporation come into a jurisdiction,

"perpetrate there the injuries outlawed, and then by retreating to its headquarters defeat or delay the retribution due".

While this dictum might have some application to the facts in Scophony, it clearly has no application here.

In the first place, Scophony was a corporation whose headquarters were in a foreign country—and if Scophony could not be sued and served in the Southern District of New York, it could not be sued anywhere else in the U.S.A. —and hence would have been effectively insulated from its alleged wrongful activities. K & M on the other hand is still a corporation registered to do business in Pennsylvania and clearly subject to service of process there.

Secondly, Scophony was admittedly engaged in certain activities within the district between the time suit was started and process was served—but the defense was that these activities did not constitute the doing of or transacting business. The Supreme Court held to the contrary. K & M at no time during the comparable period was engaged in any activities whatsoever.

Finally, the court, as pointed out in the quotes above, rejected Scophony's contention that it had ceased to do business within the district. Scophony was still very much a viable and ongoing business entity. K & M, on the other hand, had ceased doing all business—and such cessation was found by Judge Van Dusen (in granting summary judgment for K & M in the companion government civil case), to have been done for good and valid business reasons—and not in any effort to escape liability under the anti-trust laws.

Plaintiff, at pages 15 and 16 of its brief, places heavy reliance on the *Coulter* and *Ross-Bart* cases because these

two District Court cases picked up the "hit and run" language of *Scophony* discussed above and applied it to a resolution of venue and service problems.

Plaintiff cites *Coulter* as authority for the proposition that "transacts" can mean "transacted," because the court held venue proper in a district where defendant had filed an affidavit purporting to show that it had transacted no business within the district within the past year (Plaintiff's brief, page 15). But plaintiff fails to mention that the plaintiff in *Coulter* alleged that defendant had continued to do business in the district to the time of service, though it might have ceased doing "regular" business there.

Plaintiff cites *Ross-Bart* for the same proposition (Plaintiff's brief, page 16). But *Ross-Bart* held only that the absence of the defendant in the district did not preclude *service of process* there. On the issue of *venue, Ross-Bart* is authority for the opposite proposition:

> "Of course, the present decision does not foreclose the defendant from renewing the point now made, either on the claim of *no venue* or in the defense of no participation in the offenses alleged." (at 403) (Emphasis added).

Plaintiff's argument makes much of the possibility that a firm may cease to do business in a state merely to make the bringing of an action more difficult for the plaintiff. We submit that here, with no evidence of bad faith, Congressional intent would be carried out by holding that K & M was not transacting business in California for venue purposes of Section 12.

When a firm ceases to do business within a state, there is a difference between "retreating" to avoid suit ("hit and run") and "liquidating" a corporation for legitimate busi-

ness reasons. The former is what the Court in Scophony (where interlocking directorates between a parent and subsidiary corporation were concerned) was referring to when it looked to elements of transacting business.

It would, we submit, frustrate the purposes of the Clayton Act to read a Congressional intent into § 12 to penalize K & M's decision to liquidate by making it defend a suit three thousand miles from its home, when the decision to liquidate was undertaken in good faith and for reasons of economic efficiency.

There is no allegation here that K & M's liquidation was to avoid suit. The evidence in fact all points in K & M's favor. Judge Van Dusen, in granting K & M's Motion for Summary Judgment (*U.S. v. Johns-Manville Corp., et al.,* supra), said, quoting from an affidavit filed by Mr. Bateman, a member of K & M's Board of Directors:

> "The decision to sell the pipe business was dictated by valid and bona fide business reasons." (R. p. 59)

Further, Justice Van Dusen said:

> "None of the principal officers of K & M during the period from the spring of 1957 to April 1962 are now employed by Certain-teed (the corporation acquiring K & M's assets, except for the former sales manager." (R. p. 61)

and concluding (R. p. 70):

> "The record does not support the government's charges that the sale of the asbestos-cement pipe assets of K & M was done to avoid the anti-trust laws, that the sale of assets was a change in form rather than substance, and that neither K & M nor its parent T & N, has abandoned the offensive conduct of which it is accused."

VII.

CONCLUSION

In short, we find no compelling reasons of anti-trust policy which would dictate that venue be brought in California.

We submit that the Congress for good cause has decided not to make a corporation subject to suit in any judicial district wherever it, at any time, had transacted any business.

If plaintiff has a valid cause of action, it should bring this action against this defendant within the judicial district of the state wherein the defendant corporation is an "inhabitant"—and nowhere else. We respectfully ask your Honorable Court to affirm the dismissal of this case for lack of proper venue.

Dated: San Francisco, California, July 26, 1965.

Respectfully submitted,

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By Christopher M. Jenks
Attorneys for Appellee

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: San Francisco, California, July 26, 1965.

Christopher M. Jenks
Attorney for Appellee

No. 20,094

United States Court of Appeals

For the Ninth Circuit

EASTLAND CONSTRUCTION CO., INC.,
Appellant,

vs.

KEASBEY AND MATTISON COMPANY,
Appellee.

BRIEF FOR APPELLANT

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No. 20,094

United States Court of Appeals

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BRIEF FOR APPELLANT

I

JURISDICTION

This appeal arises out of the case captioned Eastland Construction Co., Inc., Plaintiff, v. Johns-Manville Corp., and Keasbey and Mattison Company, Defendants, No. 43012, filed in the United States District Court for the Northern District of California (San Francisco) on November 18, 1964. The single count complaint [R. pp. 1-9] charged that defendants had engaged in a combination and conspiracy to restrain interstate and foreign trade and commerce in the production and sale of asbestos-cement pipe and couplings in violation of Section 1 of the Sherman Act, and further, that the defendants have combined and conspired to monopolize the same trade and commerce in asbestos-cement pipe and couplings in violation of Section 2 of the Sherman Act and further, that each defend-

ant, acting unilaterally, had attempted to monopolize the aforesaid trade and commerce in violation of Section 2 of the Sherman Act. Plaintiff alleged that, as a result of these violations of the antitrust laws, it was "overcharged" for asbestos-cement pipe produced by defendants. Jurisdiction of the District Court rests on Section 4 of the Clayton Act (15 U.S.C. 15).

On February 11, 1965, defendant Keasbey and Mattison Company (hereinafter K&M) moved, *inter alia,* to dismiss the complaint because of improper venue. That motion rested on the ground that K&M was not at the time this action was filed, or at the time of the purported service of summons, an inhabitant of, found in, or transacting business in the Northern District of California. [R. pp. 10-11]

On March 17, 1965, the District Court entered its order which recited that:

> "Counsel for plaintiff having conceded that as of June 1, 1962 the defendant Keasbey and Mattison Company ceased to do business in California and has not done any business in this state since, the Court finds that at the time of the filing of the instant complaint (November 18, 1964) and for two years, five months and eighteen days this district was not a district wherein said corporation may be found or 'transacts business'. This Court is therefore without proper venue as to this corporation and by reason thereof, IT IS ORDERED that the complaint herein is dismissed as to defendant Keasbey and Mattison Company." [R. p. 149]

On April 2, 1965, the Court entered its final judgment dismissing the complaint as to K&M. The judgment re-

cited "there is no just reason for delay and having expressly directed the entry of judgment herein . . ." [R. p. 154]

This Court has jurisdiction of this appeal under the provisions of 28 U.S.C. 1291. See also Rule 54(c) of the Federal Rules of Civil Procedure, as amended; *Sigmund v. General Commodities Ltd.*, 175 F. 2d 952 (9th Cir. 1949); *Republic of China v. American Express Co.*, 190 F.2d 334 (2nd Cir. 1951); *Youpe v. Moses*, 213 F.2d 613 (D.C. 1954); *Seaboard Surety Co. v. Westwood Lake, Inc.*, 277 F.2d 397 (5th Cir. 1960).

II

STATUTES INVOLVED

15 U.S.C. 15 provides, in pertinent part:

> "Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover three-fold damages by him sustained . . ."

15 U.S.C. 16(b) provides in pertinent part:

> "Whenever any civil or criminal proceeding is instituted by the United States to prevent, restrain, or punish violations of any of the antitrust laws, . . . the running of the statute of limitations in respect of every private right of action arising under said laws and based in whole or in part on any matter complained of in said proceeding shall be suspended during the pendency thereof and for one year thereafter . . ."

15 U.S.C. 22 provides:

> "That any suit, action, or proceeding under the antitrust laws against a corporation may be brought not only in the judicial district whereof it is an inhabitant, but also in any judicial district wherein it may be found or transacts business; and all process in such cases may be served in the district of which it is an inhabitant, or wherever it may be found."

III

STATEMENT OF THE CASE

The facts upon which this appeal is based are quite simple. On June 1, 1962, a federal grand jury sitting in the Eastern District of Pennsylvania returned an indictment charging K&M, among others, in two counts, with violations of the antitrust laws. That indictment [R. pp. 41-51], filed on June 1, 1962, became criminal case No. 21118 in the United States District Court for the Eastern District of Pennsylvania (hereinafter referred to as the Government case).[1] The allegations of the complaint in the action below are substantially identical with and are predicated upon the indictment in the Government case and the facts elicited during the trial thereof.

On June 1, 1962, the same day upon which the indictment was returned, K&M, pursuant to a written agreement, sold all, or substantially all, of its asbestos-cement

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[1]After a jury trial of about 4½ months, each defendant was acquitted on all charges; as to some defendants and charges the Court granted a motion for judgment of acquittal; as to the remaining charges and defendants, the jury returned a "not guilty" verdict. A companion civil case is now pending.

pipe and coupling business, including its plants, equipment, accounts, records, trade names, patent rights and other assets employed by K&M in connection with the manufacture, sale and distribution of asbestos-cement pipe and couplings. [R. p. 60] Included in the foregoing sale was an asbestos-cement pipe producing plant owned by K&M and located in Santa Clara, California—a location within the judicial district of the Court below. [R. p. 98]

Subsequent to the sale (the exact date not appearing in the record below), defendant K&M withdrew its certificate of transacting business in California. By November 18, 1964, the date on which the complaint in this case was filed, K&M had instituted proceedings, in accordance with the law of Pennsylvania, the State of its incorporation, to dissolve, and was awaiting a final tax clearance from Pennsylvania upon receipt of which K&M asserted that it would formally terminate its corporate existence. [R. p. 113]

At the oral argument on the motion to dismiss for lack of venue, counsel for appellant conceded in open Court that defendant K&M had not transacted business in the State of California since June 1, 1962. The Court below concluded that the period of two years, five months and eighteen days—the time between June 1, 1962 and the filing of the complaint on November 18, 1964—rendered the Court below without proper venue as to defendant K&M and that accordingly, the Northern District of California "was not a district wherein said corporation may be found or 'transact business'". [R. p. 149] Final judgment of dismissal dated and filed April 2, 1965 was entered upon this order. [R. p. 154]

IV

QUESTION PRESENTED

The sole question presented by this appeal is whether a foreign corporation named as a defendant in a private antitrust case filed in California may immunize itself from suit in California by a cessation of its business transactions in California during a period when the running of the statute of limitations is suspended as to that defendant by reason of a prior Government proceeding.

V

SUMMARY OF ARGUMENT

By dismissing the complaint as to defendant K&M on the grounds that the Northern District of California was not the proper venue for this action, the District Court fashioned a rule which not only diametrically conflicts with the expressed intention of Congress, but which also ignores the repeated admonitions of the Supreme Court of the United States in interpreting the Congressional mandate. The bizarre result necessarily flowing from the decision below is that a defendant as to which the running of the statute of limitations is suspended may, by the sale of its assets and withdrawal to its corporate headquarters, require a plaintiff either (1) to wait for the conclusion of the Government case and then to "chase" the defendant to its headquarters office or (2) to give up the benefits of the tolling provision (15 U.S.C. 15(b)) and sue immediately so as not to lose the benefits of the venue statute (15 U.S.C. 22).

Rather than subject an antitrust plaintiff to this "Hobson's choice", the District Court, in dealing with this question should have fashioned a rule designed to further—not defeat—the Congressional policy set forth in the statutory complex governing the institution and conduct of private antitrust proceedings. Where those statutes would *appear* to conflict, a rule should be developed to accommodate the well established policy of the law which regards treble damage actions as an important component of the public interest in the vigilant enforcement of the antitrust laws. Such an accommodation would lead to a rule which recites that a foreign corporation, which has transacted business in a district in which it has allegedly inflicted injury by reason of violations of the antitrust laws, may be sued within that district even though it is no longer transacting business in the district at the time suit is brought—if the suit is instituted by the plaintiff within the period of time during which the running of the statute of limitations is suspended as to that defendant.

VI

ARGUMENT

This Court has astutely observed that:

> ". . . a niggardly construction of the treble damage provisions would do violence to the clear intent of Congress. The private antitrust action is an important and effective method of combatting unlawful or destructive business practices. A private suitor complements the Government in enforcing the antitrust laws. The treble damage provision was designed to foster and stimulate the interest of private business in main-

> taining a free and competitive economy. Its efficacy should not be weakened by judicial consideration." (*Flintkote Co. v. Lysfjord,* 246 F.2d 368, 398 (9th Cir. 1957).)

And, more recently, this Court has pointed out that "private treble damage actions are an important component of the public interest of 'vigilant enforcement of the antitrust laws' ". *Olympic Refining Co. v. Carter,* 332 F.2d 260, 264 (9th Cir. 1964), cert. denied 85 S.Ct. 186 (1964). See also *Lawlor v. National Screen Service Corp.,* 349 U.S. 322, 329, 75 S.Ct. 865 (1955); *Bruce's Juices, Inc. v. American Can Co.,* 330 U.S. 743, 751-2, 67 S.Ct. 1015 (1947).

Where a defendant has been either indicted or sued in a civil case brought by the Government for violations of the antitrust laws, Congress has decreed that the running of the statute of limitations is suspended as to "every private right of action arising under said [antitrust] laws and based in whole or in part on any matter complained of in the said [Government] proceeding . . ." (15 U.S.C. 16(b)).

In *New Jersey Wood Finishing Co. v. Minnesota Mining & Manufacturing Co.,* 216 F.Supp. 507 (New Jersey 1963), aff'd 332 F.2d 346 (3rd Cir. 1964), cert. granted 85 S.Ct. 146 (1965), the District Court said:

> "It seems clear that Congress intended by Section 5(b) 15 U.S.C. 16(b) to allow antitrust litigants an opportunity, which might otherwise be barred by the four years statute of limitations, to take advantage of facts uncovered in related Government proceedings . . . Thus, a private party which has suffered damages to its business by reason of unlawful anti-

> trust activity is permitted additional time to derive the benefits of a Government investigation.'' (216 F. Supp. at p. 510.)

Section 5 of the Clayton Act, now 15 U.S.C. 16(b), was amended in 1955. In Senate Report 619, 84th Congress, First Session, U.S. Code Congressional and Administrative News, pp. 2328-2334, which favorably recommended the amendments, the Senate Committee on the Judiciary said:

> This bill makes several important changes in the tolling provisions of existing law. As presently written, section 5 of the Clayton Act tolls the statute of limitations with respect to private treble-damage suits during the pendency of a suit by the United States to punish or restrain violations of the antitrust laws. This period of tolling is continued by the present bill with several modifications.
>
> There are many instances where the statute of limitations as to a private cause of action may nearly have expired before suit is instituted by the Government under the antitrust laws. Although the statute is tolled during the pendency of the proceedings brought by the United States, the plaintiff in a treble-damage action may find himself hard pressed to reap the benefits of the Government suit if, upon its conclusion, he has but a short time remaining to study the Government's case, estimate his own damages, assess the strength and validity of his suit, and prepare and file his complaint. To alleviate such difficulties, the present bill would extend the tolling period not only for the duration of the Government's antitrust suit, but for 1 year thereafter. This would guarantee all plaintiffs an adequate period in which to take advantage of Government antitrust proceedings.

While the committee believes it important to safeguard the rights of plaintiffs by tolling the statute during the pendency of Government antitrust actions, it recognizes that in many instances the long duration of such proceedings taken in conjunction with a lengthy statute of limitations may tend to prolong stale claims, unduly impair efficient business operations, and overburden the calendars of courts. The committee believes the provision of this bill will tend to shorten the period over which private treble-damage actions will extend by requiring that the plaintiff bring his suit within 4 years after it accrued or within 1 year after the Government's case has been concluded.

While the committee considers it highly desirable to toll the statute of limitations during a Government antitrust action and to grant plaintiff a reasonable time thereafter in which to bring suit, it does not believe that the undue prolongation of proceedings is conducive to effective and efficient enforcement of the antitrust laws. The present bill would assure all plaintiffs of at least 4 years from the time their cause of action accrued in which to institute suit. It would also guarantee every plaintiff at least a year from the close of a Government antitrust suit to prepare his case and file his complaint. But in cases where the plaintiff's action had been suspended by the pendency of a Government antitrust proceeding, he would be required to bring his action either (a) within the suspension period, i. e., within 1 year after the Government suit had terminated, or (b) within 4 years after his cause of action accrued. (id, pp. 2332-2333).

And in enacting the original Section 5 of the Clayton Act, Congress expressed the same concern for "persons

of small means" injured by antitrust violations. The House Report on that Bill (H.R. Rep. 627, 63rd Cong. 2d Sess. p. 14) stated:

> "Section 6[2] provides that a final decree obtained by the United States in a suit to dissolve a corporation or unlawful combination may be offered in evidence in a suit brought by a private suitor for damages under the antitrust laws by reason of the unlawful acts of the defendant corporation, and that when such decree or judgment is so offered it shall be conclusive evidence of the same facts and be conclusive as to the same questions of law as between the parties in the original suit or proceeding. This section also provides that the statutes of limitations shall be suspended in favor of private litigants who have sustained damage to their property or business by the wrongful acts of the defendant during the pendency of the suit instituted by or on behalf of the United States. The entire provision is intended to help persons of small means who are injured in their property or business by combinations or corporations violating the antitrust laws.
>
> It is in keeping with a recommendation made by the President in his message to Congress on the general subject of trusts and monopolies."

Plainly, Section 5 of the Clayton Act (15 U.S.C. 16(b)) was intended to grant plaintiffs of small means the benefit of accumulating evidence from Government litigation. It thereby encouraged a prospective plaintiff to await the outcome of the Government litigation. It also gave a prospective plaintiff a year after the termination of the Gov-

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[2]Section 6 of the proposed bill became Section 5 of the Clayton Act.

ernment case to "study the Government's case, estimate his own damages, assess the strength and validity of his suit, and prepare and file his complaint". And that is precisely what appellant has done here.

But the statute also confers a concomitant benefit upon the defendant involved in Government litigation. Necessarily, by encouraging plaintiffs to await the outcome of Government litigation, the defendant finds itself free of treble damage litigation during the time its attention must be directed to defense of the Government suit. Thus, viewed in totality, the statute has the effect of granting to prospective plaintiffs and defendants alike a "stay" so that the Government litigation may be resolved.

But Section 5 of the Clayton Act (15 U.S.C. 16(b)) must be read as part of an interlacing text along with Section 12 of the Clayton Act (15 U.S.C. 22) which governs the forum in which an antitrust plaintiff may sue. It is no longer open to question that in enacting Section 12 of the Clayton Act Congress enlarged the venue provisions of the antitrust laws so that suits could be brought by a plaintiff against a defendant in the district not only where the defendant resides or was found, but also in any district where a defendant "transacts business". *Eastman Kodak Co. v. Southern Photo Materials Co.*, 273 U.S. 359, 47 S.Ct. 400 (1927).

The purpose of Congress in enlarging the venue provisions under the antitrust laws was to relieve

> "persons injured through corporate violations of the antitrust laws from the 'often insuperable obstacle' of resorting to distant forums for redress of wrongs done in the places of their business or residence. A

> foreign corporation no longer could come to a district, perpetrate there the injuries outlawed, and then by retreating or even without retreating to its headquarters, defeat or delay the retribution due." *U.S. v. Scophony Corp.,* 333 U.S. 795, 808, 68 S.Ct. 855, 862 (1948).

In *Scophony,* the Supreme Court said that it was

> "unwilling to construe Section 12 (15 U.S.C. 22) in a manner to bring back the evils it abolished . . . and thus to defeat its policy, together with that of the antitrust laws, so as to make another amendment necessary." 333 U.S. at 817, 68 S.Ct. at 866.

The Congressional intent in the enactment of Section 5 of the Clayton Act (15 U.S.C. 16(b)) and Section 12 of the Clayton Act (15 U.S.C. 22) is now well accepted. The question involved in this appeal is what result should be reached when a literal reading of the statutes would make it appear that they are in conflict.

We are unable to submit to the Court any reported decision which deals with the precise factual situation in issue here. But we respectfully submit that the conclusion reached by the court below defeats the policy of the antitrust laws and is in conflict with the intention of Congress in their enactment.

The dilemma in which this plaintiff has been placed by reason of the ruling below is as follows: On June 1, 1962 plaintiff learned (or at least is charged with knowledge) of an indictment returned against K&M charging that defendant with violations of the antitrust laws which allegedly involve and adversely affect this plaintiff. But, on June 1, 1962, the plaintiff knew nothing whatever

about the details of these alleged violations of the anti-trust laws or the facts on which the indictment was based. Recognizing the frequency of precisely such situations, Congress intended, by its enactment of Section 5 of the Clayton Act to encourage private litigants, such as this plaintiff, to await the conclusion of the Government proceedings before instituting suit. In this manner, the plaintiff would secure the benefits of the evidence as it unfolds at the trial. And the defendant secures the concomitant benefit of insuring that it will not be harassed by a multiplicity of lawsuits at the time when its attention is directed toward the defense of the Government suit. But, on the same day—June 1, 1962—K&M sells substantially all of its assets, including its plant located within this judicial district, to a third party.

Under Judge Zirpoli's ruling, plaintiff is then faced with a "Hobson's Choice". In order to sue defendant below in California at a time when it is still transacting business within the judicial district, it must, without any time in which to study the charges or await the revelation of the evidentiary facts, rush to the courthouse with a complaint. In so doing, plaintiff would lose the benefits which Congress sought to confer by Section 5 of the Clayton Act. Indeed, K&M would be losing the concomitant benefit which flows therefrom.

We respectfully submit that Congress, in the enactment of the interlacing text governing the conduct of treble damage litigation, did not intend such a bizarre result. At least two district Courts—wholly apart from the tolling statute—have held that the words "transacts business" as used in Section 12 of the Clayton Act (15 U.S.C. 22)

are not to be read literally—but are to be interpreted liberally consistent with the Congressional purpose.[3] In *Coulter Funeral Home, Inc. v. National Burial Insurance Co.,* 192 F.Supp. 522 (E.D. Tenn. 1960), the District Court, in holding a defendant to be amenable to suit within the judicial district, even though it had filed an affidavit showing that it had transacted no business within the judicial district for the past year, said:

> But in any event, the words "transact business" do not intend to mean that the defendant has to be transacting business on the day the suit is commenced. Reference is made to the case of United States v. Scophony Corp., 333 U.S. 795, 68 S.Ct. 855, 92 L.Ed. 1091, for a general discussion of this question. This case, after announcing the obvious purpose of the venue statute and its intended liberality and extension, concludes at the bottom of page 808 of 333 U.S., at page 862 of 68 S.Ct., "A foreign corporation no longer could come to a district, perpetrate there the injuries outlawed, and then by retreating or even without retreating to its headquarters defeat or delay the retribution due."
>
> This is a plain recognition that if the transaction of business, within a district, by a corporation violates the proscribed provisions charged as the basis of the suit, such corporation is amenable to suit therein despite the fact that it may have retreated. Also see Eastman Kodak Co. of New York v. Southern Photo Materials Co., 273 U.S. 359, 47 S.Ct. 400,

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[3]This Court has also acknowledged the "broad concepts and objectives of 15 U.S.C.A. 22". See *Courtesy Chevrolet, Inc. v. Tennessee Walking Horse Breeders' and Exhibitors' Assn. of America,* .... F.2d .... (1965), 1965 Trade Cases, ¶ 71,443, May 3, 1965.

71 L.Ed. 684 and United States v. Nat. City Lines, 334 U.S. 573, 68 S.Ct. 1169, 92 L.Ed. 1584. (192 F. Supp. at 523).

And in *Ross-Bart Port Theatre v. Eagle Lion Films,* 140 F.Supp. 401 (E.D. Va. 1954), the court reached precisely the same conclusion despite the fact that the defendant was absent from the forum for a full five years preceding the institution of the litigation.

If a defendant as to whom the running of the statute of limitations is suspended may, by selling its assets to a third party during the period of suspension, require each prospective plaintiff to resort to a distant forum, then the enlargement of the venue provisions granted by Congress in Section 12 of the Clayton Act (15 U.S.C. 22) is a virtual nullity. The ruling of the court below plainly ignores the direction of the Supreme Court that, in enacting Section 12 of the Clayton Act Congress intended to relieve persons injured by corporate violations of the antitrust laws from the "often insuperable obstacle" of chasing a retreating defendant to its headquarters in order to maintain the action. Plainly, the decision of the District Court here permits the classical "retreat" contemplated by the Supreme Court in *Scophony.*

15 U.S.C. 16(b) and 15 U.S.C. 22 must be read as an harmonious and interlacing context. Congress could not have, on the one hand, intended to encourage plaintiffs injured by the antitrust laws to await the outcome of prior Government litigation and, on the other hand, intended to *penalize* such plaintiffs for waiting by forfeiture of the broad venue provisions. If the tolling provision is to have any clear and consistent meaning, it

must be to preserve the status quo as of the time the Government instituted its proceeding. This would require that a defendant as to whom the statute of limitations is suspended by reason of a Government proceeding, be amenable to suit in any district in which it "transacts business" *as of the date on which the Government proceeding was instituted.*[4]

In this case, the controlling date is June 1, 1962 and on this date the defendant K&M was transacting business in this judicial district. K&M should not, by sale of its assets be permitted to "retreat to its headquarters" and thereby subject this plaintiff to the "insuperable obstacle" of requiring that it sue in Pennsylvania—and not in California where the alleged injuries were inflicted.

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[4]Even this rule may not be sufficiently liberal to accomplish the objectives sought by Congress. Suppose a corporation which has transacted business in California actually dissolves shortly before an indictment against it is returned. Because California law permits suits against dissolved corporations, the indictment does not abate as against the now defunct entity. *Melrose Distillers Inc. v. U. S.,* 359 U.S. 271 (1959). In these circumstances, it would seem harsh to permit the Government to sue in California and, at the same time, to deny a California plaintiff access to California courts. Thus, the better rule would seem to be that a defendant should be amenable to suit in any district in which it has transacted business during any part of the period for which damages can be recovered. And this rule is really then not contingent upon a prior Government suit. However, it is unnecessary to reach this more difficult question on the facts of this case.

VII

CONCLUSION

The decision of the District Court is erroneous. It conflicts with the clear intention of Congress and with the decisions of the Supreme Court. Accordingly, the judgment below should be reversed and the complaint reinstated as to defendant K&M.

Dated, San Francisco, California,
May 18, 1965.

Respectfully submitted,
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Attorneys for Appellant.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

MAXWELL M. BLECHER,
Attorney for Appellant.

No. 20093

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ROY HUNTER, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA,
NORTHERN DIVISION

BRIEF FOR THE APPELLEE

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I N D E X

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IN THE UNITED STATES COURT OF APPEALS

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No. 20093

ROY HUNTER, Appellant

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<u>APPEAL FROM THE UNITED STATES DISTRICT COURT
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NORTHERN DIVISION</u>

BRIEF FOR THE APPELLEE

OPINION BELOW

The district court's memorandum opinion and order, dated October 21, 1964 (C.T. 74-81),[1] is reported at 236 F.Supp. 178.

JURISDICTION

This action to perpetually enjoin appellant from causing cattle under his control to graze or water within the

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1/ The original papers transmitted to the Court and the reporter's transcript are in two separate volumes and will be referred to in this brief as the Clerk's transcript (C.T.) and the Reporter's transcript (R.T.), respectively.

Death Valley National Monument was initiated by the United States. The district court had jurisdiction under the provisions of 28 U.S.C. sec. 1345. On January 12, 1965, judgment was entered for the United States (C.T. 87). Notice of appeal was filed on March 10, 1965 (C.T. 96). Jurisdiction of this Court rests on 28 U.S.C. sec. 1291.

QUESTIONS PRESENTED

1. Whether, even assuming the existence of a right to water livestock at springs and water holes on the public domain, grazing livestock on the public domain without a permit is illegal.

2. Whether the laws of the United States and the local customs, laws, and court decisions of California recognize the acquisition of appropriative rights to springs and water holes on the public domain for stock watering purposes.

STATUTES, PRESIDENTIAL PROCLAMATIONS, RULES AND REGULATIONS INVOLVED

The statutes, Presidential Proclamations and rules and regulations involved in this case are set forth in Appendix.

STATEMENT

By Presidential Proclamation dated February 11, 1933, he Death Valley National Monument was established to preserve he unusual features of scenic, scientific and educational in- erest contained in certain lands known as Death Valley, Califor- ia. Prior to the establishment of the Monument, the lands in- luded therein were part of the public domain owned by appellee nd were included in the said Monument subject to all vested xisting rights.

Supervision, management and control of the lands sit- ated within the Monument were delegated by the President to the irector of the National Park Service, under the supervision of he Secretary of the Interior, as provided in the Act of August 25, 916 (39 Stat. 535-536), and acts additional thereto and amenda- ory thereof. Under this statute the Secretary of the Interior ay, under such rules and regulations and on such terms as he may rescribe, grant the privilege to graze livestock within any ational park (except Yellowstone), monument or reservation.

Section 3, 39 Stat. 535, as amended (16 U.S.C. sec. 3). Without a permit from an authorized officer or employee of the National Park Service, the running at large, herding, driving across, or grazing of livestock of any kind on government lands in the parks and monuments is prohibited. 36 C.F.R. sec. 1.20.

The undisputed facts are that for many years appellant has continuously grazed and watered cattle on the Monument, although he has never had or applied for a permit from appellee authorizing him to do so. Appellant and his predecessor were repeatedly notified by appellee, through the Superintendent of the Park Service, Death Valley National Monument, that their cattle were trespassing on Monument lands, and were requested to remove the animals without delay. Appellant and his predecessor refused to comply with those requests and continued to water and graze their cattle within the boundaries of the Monument.

On July 3, 1962, appellee filed a complaint asking that appellant be perpetually enjoined from watering and grazing his cattle on the Monument. Appellant's defense was, in short, that he needed no permit to graze on these public lands but he had,

claimed, a right to water cattle which carried with it an
plied right to graze. Trial was held before the court on
ly 16, 1964, and on October 21, 1964, the district court's
morandum and order granting the injunction and directing ap-
llee to prepare and lodge findings of fact, conclusions of
w and form of judgment were filed. At a hearing on November 16,
64, appellant's objections to the proposed findings of fact sub-
tted by appellee were sustained and appellant was granted leave
propose amendments to the proposed findings of fact. The
urt further granted appellant a stay of execution pending ap-
al pursuant to Rule 62(a), F.R.Civ.P. On January 12, 1965,
e findings of fact, incorporating appellant's proposed amend-
nts, and conclusions of law were filed and entered. On that
me date, judgment perpetually enjoining appellant from water-
g and grazing cattle under his control within the boundaries
the Death Valley National Monument and staying execution un-
l the expiration of the period for the taking of an appeal was
led and entered. This appeal followed.

SUMMARY OF ARGUMENT

I

In the absence of a permit granted by the United States grazing of cattle or other livestock within the boundaries of the Death Valley National Monument is prohibited. Rights of way for grazing livestock on public or reserved land of the United States are not incidental to water rights and such rights of way will not be implied from legislation recognizing rights of way for the construction of ditches, pipe lines, canals or reservoirs.

II

The water rights to be protected under the Act of 1866 and the Desert Land Act of 1877 are rights thereby authorized to be established in accordance with local customs, laws and court decisions. In California the local customs, laws and court decisions do not recognize acquisition of appropriative rights to springs and water holes on the public domain for stock watering purposes. Neither do the relevant acts of Congress.

ARGUMENT

I

REGARDLESS OF EXISTENCE OF CLAIMED WATER RIGHT, APPELLANT'S GRAZING IN THE DEATH VALLEY NATIONAL MONUMENT WITHOUT LICENSE IS ILLEGAL

Appellant argues that he has vested appropriative rights to water cattle from certain springs on the National Monument and that inseparably connected to those rights is the right, in the nature of an easement or right of way, to graze cattle on the public lands surrounding those springs. We submit that neither appellant nor his predecessors could have obtained a vested right of way over and across public lands for grazing and watering cattle thereon, even if it were assumed that they could have and did acquire a right to use the water.

Since 1934, the extent of rights of grazing of cattle on public lands has been controlled by the Taylor Grazing Act, 48 Stat. 1269 (1934), 43 U.S.C. sec. 315 et seq. Prior to the Taylor Grazing Act, there was held to be an implied license, growing out of the custom of nearly a hundred years that the unreserved

public lands of the United States should be free to the people seeking to use them where such lands were left open and unenclosed, and no act of Government forbids such use. Buford v. Houtz, 133 U.S. 320, 326 (1890). However, failure of the United States to object to such use of public lands did not confer any vested right to graze which could not be withdrawn by a subsequent reservation of the public lands. Light v. United States, 220 U.S. 523, 535 (1910). By the passage of the Taylor Grazing Act, and by the reservation of the Death Valley Monument, any "implied license" to graze was revoked in favor of a statutory permit system. As pointed out in Osborne v. United States, 145 F.2d 892, 896 (C.A. 9, 1944), "It is safe to say that it has always been the intention and policy of the government to regard the use of its public lands for stock grazing, either under the original tacit consent or * * * under regulation through the permit system, as a privilege which is withdrawable at any time for any use by the sovereign without the payment of compensation. Indeed, concessions to individuals for the use of public property or the enjoyment of rights peculiar to the sovereign have been

consistently construed with strictness against the concessionee and in favor of the sovereign."

With respect to the public domain, the Constitution vests in Congress the power of disposition and making of all needful rules and regulations. That power is subject to no limitation. Utah Power & Light Co. v. United States, 243 U.S. 389 (1916). The Death Valley National Monument was established by Presidential Proclamation on February 11, 1933, pursuant to Section 2 of the Act of Congress approved June 8, 1906 (34 Stat. 255), and the Director of the National Park Service, under the direction of the Secretary of the Interior, was delegated the supervision, management and control of the Monument, as provided in the Act of Congress entitled "An Act to Establish a National Park Service, and for Other Purposes," approved August 25, 1916 (349 Stat. 535-536), and Acts additional thereto or amendatory thereof. 16 U.S.C. sec. 3. Pursuant to the authority of the Act of August 25, 1916, as amended (16 U.S.C. sec. 6), 36 C.F.R. 1.20, was promulgated and provides in part as follows:

> (a) The running at large, herding, driving across, or grazing of livestock of any kind on government lands in the parks and monuments is prohibited, except where authority therefor has been granted pursuant to a revocable permit issued by an authorized officer or employee of the National Park Service * * *.

This regulation was plainly valid and controls this case. As appellant has no permit from the Federal Government, he has no right to graze and water livestock on the National Monument.

The alleged existence of an appropriative water right does not enlarge appellant's rights. An appropriation of water purportedly made and maintained under the laws of California, gives no right of way over the public lands of the United States for a reservoir or canal to use water, United States v. Rickey Land & Cattle Co., 164 Fed. 496 (C.C. N.D. Cal. 1908), and this although the particular circumstances be such that the proposed appropriation cannot be effected without the ditch or reservoir. Snyder v. Colorado Gold Dredging Co., 181 Fed. 62, 69 (C.A. 8, 1910). A right of way across state lands in order to appropriate water will not be implied from the provisions of the state law allowing appropriation of water. State of California v. Hansen, 189 C.A.2d 604 (1961).

The lands herein involved are and at all times pertinent hereto have been owned by the United States. The power "to dispose of and make all needful rules and regulations respecting" the lands of the United States is given exclusively to the Congress (Constitution, Art. IV, sec. 3, cl. 2) and only through some form of exercise of that power can rights in lands belonging to the United States be acquired. Utah Power & Light Co. v. United States, 243 U.S. 389, 404 (1916). As this Court recently held in Superior Oil Company v. United States, F.2d (C.A. 9, 1965),[2/] easements are not to be implied in derrogation of the interest of Congress.

Here Congress has spoken expressly as to grazing rights in the Taylor Grazing Act. As to other easements needed to promote the development of water found in the public domain, in 1866 it recognized rights of way for the construction of ditches, pipe lines and canals. 14 Stat. 253, sec. 9; Rev. Stat. sec. 2339,

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2/ Copies of this unreported opinion are transmitted with this brief to counsel for appellant.

July 26, 1866, 43 U.S.C. sec. 661. This legislation, known as the Act of 1866, was amended in 1870 to provide that patents or homestead rights should be subject to any vested and accrued water rights, or rights to ditches and reservoirs used in connection therewith, as may have been acquired or recognized by Section 9 of the Act of 1866. 16 Stat. 218; Rev. Stat. sec. 2340 (July 9, 1870), 43 U.S.C. sec. 661. Nowhere in these statutes is there a recognition of rights of way across public land for cattle to graze and water. No court which has been called upon to interpret this legislation has rendered a decision recognizing or even indicating the possibility of recognition of a right of way in the nature of that claimed by appellant

Subsequently, when hydroelectric power was developed, it was found that this legislation was, at best, poorly adapted to these needs. The statutes were limited to ditches, canals and reservoirs, and did not cover power houses, transmission line or the necessary subsidiary structures. In that situation Congress passed the Act of May 14, 1896, c. 179, 29 Stat. 120, which

related exclusively to rights of way for electric power purposes. Utah Power & Light Co. v. United States, 243 U.S. 389, 405 (1916). Grazing and watering of cattle, however, unlike works for generating and distributing electric power, were known and should have been in the mind of Congress at the time the Acts of 1866 and 1870 were passed, yet no provision was made in those Acts for rights of way for such purpose. Although Congress has since passed a number of Acts specifically relating to rights of way, such as the 1896 Act mentioned above, none of them has provided for rights of way for grazing or watering livestock. The words of the Act of 1866 have been interpreted as being broad enough to include dams, flumes, pipes and tunnels on the theory that such dams, flumes, pipes and tunnels were analogous to or incidental to and discharging the functions of such reservoirs, ditches and canals. Utah Light & Traction Co. v. United States, 230 Fed. 343, 345 (C.A. 8, 1915), cited in Peck v. Howard, 167 P.2d 753, 761 (Cal. 1946). Those words are not, however, broad enough to include rights of way for watering and grazing livestock.

Appellant's argument is thus fallacious because (1) it violates the policy of Congress explicitly to state which easements to reach water will be permitted in the public domain and on what terms, (2) it violates the basic policy of public disposal requiring specific statutory authority resulting in patent expressly stating the scope of the grant, (3) it would create, by implication, limitations upon grants made under the general land disposal laws and (4) it would transfer to the courts by drawing implications the function of determining the scope of public land grants which Congress has always determined for itself or delegated to the Secretary of the Interior.

II

APPELLANT HAD NO VESTED WATER RIGHT AS CLAIMED

Before the establishment of the Death Valley National Monument, the lands included therein were part of the public domain and were included in the Monument subject to all valid existing rights. Prior to 1866, the right of a prior appropriator to the waters in the public domain had been recognized by

California as against other appropriators but not against the Federal Government. However, in 1866 Congress passed a statute, 14 Stat. 253, R.S., sec. 2339, 43 U.S.C. sec. 661 (hereafter referred to as the Act of 1866), providing that:

> Wherever, by priority of possession, rights to the use of water for mining, agricultural, manufacturing, or other purposes, have vested and accrued, and the same are recognized and acknowledged by the local customs, laws and decisions of courts, the possessors and owners of such vested rights shall be maintained and protected in the same; * * *.

In 1877, in the Desert Land Act (19 Stat. 377), Congress enacted what is the currently effective authorization for the acquisition, as against the United States, of privately owned rights to use the unappropriated, non-navigable, waters upon the public lands. See <u>Federal Power Comm.</u> v. <u>Oregon</u>, 349 U.S. 435, 447-448 (1954). There it was provided that (43 U.S.C. sec. 321):

> * * * and all surplus water over and above such actual appropriation and use, together with the water of all lakes, rivers, and other sources of water supply upon the public lands and not navigable, shall remain and be held free for the appropriation and use of the public for irrigation, mining, and manufacturing purposes subject to existing rights.

Neither the Act of 1866, nor the Desert Land Act specified the procedure by which rights could be acquired from the United States. However, in California, as in other states to which these laws applied, the local customs, laws and decisions of courts were accepted as the criteria for determining the acquisition of privately owned appropriative rights to use the waters on the federally owned public lands. California Oregon Power Co. v. Beaver Portland Cement Co., 295 U.S. 142 (1935). Appellant argues that, in accordance with the local customs, laws and decisions of courts, he and his predecessors acquired vested appropriative rights to use certain waters located within the boundaries of the Death Valley National Monument.

There are at least four reasons why appellant's argument is wrong. First, a vested right to the use of water cannot be acquired for any purpose unless the appropriator has or has acquired a right in the adjacent lands as necessary to give him access to the water. State of California v. Hansen, 189 C.A.2d 604 (1961). Snyder v. Colorado Gold Dredging Co., 181 Fed.62, 70 (C.A. 8, 1910). As demonstrated under Point I above, neither

appellant nor his predecessors have ever acquired such a right in the lands which must be traversed by his cattle to have access to the waters, the right to use which he claims to own.

Second, appellant's claim of vested right to the water must rest completely in the appropriative doctrine. The United States was and is the owner of all riparian land. Thus, appellant's argument that it acquired vested appropriative rights without ownership of any property benefited is novel and contrary to basic water law.

Third, in order for the appellant or his predecessors to have acquired vested appropriative rights to the waters in question, those waters had to be subject to appropriation. We submit that under the local customs, laws and court decisions of the State of California the waters in question were not subject to appropriation.

In 1911 the California legislature defined water subject to appropriation, and provided that all water flowing in any natural channel, except so far as it has been or is being

applied to use for beneficial purposes, or insofar as it may be reasonably needed for use for beneficial purposes on lands riparian thereto, or except as otherwise appropriated, is public water of the State subject to appropriation in accordance with statutory provisions. Wat. Code sec. 102 (formerly part of C.C. sec. 1410). Prior to passage of that Act, the California laws had permitted the acquisition by appropriation of the right to the use of running water flowing in a river or stream or down a canyon or ravine. Cal. Civ. Code 1874, sec. 1410.

Appellant claims to have acquired vested appropriative rights to use the waters of 26 springs and one small creek that flows a short distance before disappearing into the ground. In his opening brief, he states that water from springs may be appropriated (Appellant's opening brief, 36). This statement is too broad. Whether waters of a spring are subject to appropriation under California law depends on the nature of the particular spring. A water right is a usufructuary right, i.e., a right to use the water that will be regarded and protected as property,

but which carries with it no specific property in the water itself. Wiel, Water Rights in the Western States (3d ed.) sec. 18. However, under certain circumstances the California courts have declared that the owner of the land on which a spring is located actually owns the water flowing from that spring. In the case of Simons v. Inyo Cerro Gordo Mining & Power Co., 192 Pac. 144, 150 (Cal. 1920), the Circuit Court of Appeal, Second District, Division 2, California, made the following statement:

> There no more could be private ownership in the springs themselves than there could be private ownership in the corpus of a stream of running water. There could be but a usufructuary right. And that right could be acquired only by an "appropriation" made in the manner provided by law; that is by reducing the water to actual possession for a beneficial use.

In denying a petition for rehearing in that same case, the California Supreme Court, sitting en banc, declared:

> We also refuse to approve the broad statement that there cannot be a private ownership in springs of water. The case is not parallel to the question of the ownership of the water of a stream. A spring may have no natural outlet, in which case the owner of the land in which it lies, under ordinary circumstances, owns the water as completely as he does the soil. I.D. at 152. (Emphasis added.)

On this same point the California Supreme Court said in a later case, San Francisco Bank v. Langer, 110 P.2d 687, 689-690 (Cal. 1941):

> Irrespective of its source, water from a spring flowing into a water course is part of its natural flow and its use is governed by the doctrine of riparian rights. It follows that the owner of land upon which a spring rises and from which a stream flows has no absolute ownership of the waters in the spring, but is entitled only to a reciprocal share, as a riparian owner, in common with other owners farther down on the stream. But where the natural flow from a spring does not pass beyond the boundary of the land on which it is located, the owner may use all of it; he owns it as completely as he owns the soil. (Emphasis added.)

In a recent California case, the defendant had discovered a spring in a ravine on a section of state-owned land in the desert area of Kern County. The terrain in the area was hilly and rugged, apparently quite similar to the land involved in this case. Water from the spring did not flow off the state land but merely moistened the ground thereabouts; and was not the source of any water course. Defendant went on the state land, without a permit, and spent a large amount of money developing the spring

and laying a pipe line across state land to his own land, which surrounded the state land. The state brought an action to enjoin the defendant. The injunction was granted and the defendant appealed. In affirming the judgment, the District Court of Appeal, Fourth District, concluded that: This was a spring with no natural outlet; the owner of the land in which it lies, under ordinary circumstances, owns the water as completely as the soil, citing Simons v. Inyo Cerro Gordo Mining & Power Co., supra, and San Francisco Bank v. Langer, supra; and the waters of the spring were not subject to appropriation. State of California v. Hansen, 11 Cal. Rptr. 335, 339, 189 C.A.2d 604, 610 (1961). See also York v. Horn, 154 C.A.2d 207, 213 (1957). Appellant's position is, of course, much weaker than that of the claimant in Hansen who at least owned the land where the water was used.

Counsel for appellant, in his opening argument before the district court, used the following picturesque language in describing the waters in the case at bar (R.T. 8-9):

> * * * [W]hen we speak of spring water in the Western states, we aren't talking about artesian wells, such as we may read in English poetry,

> but we're talking of mudholes, * * *. This was surface water that seeped out of the ground, maybe a half-gallon, maybe a quarter-gallon and, if it was a good spring, maybe a gallon a minute. This water would seep out if it were to be used. You had to gather the water. You had to let it form a pool and then you had to transport or divert that water to some kind of a tank or a trough where livestock could drink out of it. If you didn't do that, this water was lost. In a short time it goes into mud and would disappear into the ground.

Appellant himself testified before the district court that the springs produced very limited amounts of water which if not collected in a tank or trough would "form a kind of mudhole and disappear into the sand" (R.T. 36, 38-39) and that the so-called Cottonwood Creek also produces a limited amount of water and flows a brief distance before sinking into the ground and disappearing within the boundaries of the National Monument (R.T. 18, 46, 53).

The record here evidences the fact that the waters in this case are identical to those involved in the _Hansen_ case, _supra_. They have no natural outlet, they do not pass from appellee's lands, and they are not part of a water course. These waters are not subject to appropriation, under California law,

and it is therefore impossible for appellant or his predecessors to have acquired any vested appropriative water rights under that law as it is claimed they did.

The fourth defect in appellant's claim of vested water rights for stock raising in the springs is the fact that Congress and, so as appears, the State of California[3/] have assumed that rights to such waters are not subject to appropriation.

3/ That the State of itself is without authority or power to authorize the acquisition of rights as against the United States to use the waters on the lands of the United States is clear from decisions of the Supreme Court of California and the Supreme Court of the United States. In Lux v. Haggin, 69 Cal. 255, 339, 10 Pac. 674, 721 (1886), the California court long ago recognized that "* * * since the act of Congress granting or recognizing a property in the waters actually diverted and usefully applied on the public lands of the United States, such rights have always been claimed to be deraigned by private persons under the act of Congress, from the recognition accorded by the act, or from the acquiescence of the general government in previous appropriations made with its presumed sanction and approval." In United States v. Grand River Dam Authority, 363 U.S. 229 (1960), the Supreme Court, in denying the authority's claim that it had compensable water rights under an act of the Oklahoma legislature, declared: "Yet, the Federal Government was the initial proprietor in these western lands and any claim by a State or by others must derive from this Federal title."

Appellant places considerable emphasis on the case of Steptoe Livestock Co. v. Gulley, 53 Nev. 163, 295 Pac. 772 (1931) But that case involved flowing streams not springs. Moreover, it is the local customs, laws and court decisions of the State of California, not those of Nevada, that are to be used in determining whether appellant or his predecessor can base a claim of appropriative water rights on local customs, laws and court decisions. Granted that the Steptoe case stands for the propositio that Nevada law permits the acquisition of appropriative water rights by watering livestock, but there are also cases in other states that hold the opposite. See, e.g., Robinson v. Schoenfel 218 Pac. 1041 (Utah 1923).

Appellant also argues that under California law the watering of cattle is recognized as a reasonable, beneficial use (Appellant's opening brief, p. 26). However, both cases cited by appellant as authority for that statement involve the determination of water rights among riparian owners. A riparian owne has the right to use sufficient water from the stream to supply the needs of stock and animals ordinarily kept to sustain the

domestic needs of man. However, in a case in which a downstream riparian owner claimed that the use of water exclusively for watering livestock grown for commercial purposes was superior to the use of water for irrigation by an upstream riparian owner, the court was of the opinion that the riparian right to water livestock did not extend to watering livestock grown or pastured for commerical purposes and therefore the right of the downstream riparian owner to use the water for irrigation was superior. Cowell v. Armstrong, 210 Cal. 218, 224-225, 290 Pac. 1036 (1930). Although it does not say so in the decision, it would appear that the court recognized that under the local customs, laws and court decisions of California appropriative rights cannot be acquired by watering livestock. In any event, it is clear that California's determinations that riparian rights to use the waters of a flowing stream for some stockwatering purposes are not authority for the proposition that the laws of that State permit the acquisition by appropriation of the right to use the waters of the springs and water holes on the public lands for stockwatering purposes.

We have noted above that the Desert Land Act provides that the surplus waters on the public lands shall be "free for

the appropriation and use of the public for irrigation, mining, and manufacturing purposes." Supra, p. 15. The authorization plainly does not include grazing and stockwatering purposes at springs. While the precursor Act of 1866 did refer to "mining, agricultural, manufacturing, or other purposes," we think it is clear that Congress was never under any disillusionment that it had authorized the acquisition of privately owned rights to use springs and water holes such as here involved for the watering of livestock being grazed on the public lands. By the Act of December 29, 1916, 39 Stat. 862, 43 U.S.C. secs. 291-302, Congress provided for the making of stock-raising homestead entries upon the unappropriated unreserved public lands. By Section 10, 39 Stat. 865, 43 U.S.C. sec. 300, it was specifically directed:

> That lands containing water holes or other bodies of water needed or used by the public for watering purposes shall not be designated [for entry] under this Act but may be reserved * * * and such lands heretofore or hereafter reserved shall, while so reserved, be kept and held open to public use for such purposes under such general rules and regulations as the Secretary of the Interior may prescribe; * * *.

Authority to reserve additional lands to insure access "by the public" to the reserved watering places was also granted. In pursuance of the authority granted by Section 10 of the stock raising homestead act and Executive Order dated April 17, 1926, provided:

> It is hereby ordered that every smallest legal subdivision of the public land surveys which is vacant unappropriated unreserved public land and contains a spring or water hole, and all land within one-quarter of a mile of every spring or water hole located on unsurveyed public land be, and the same is hereby, withdrawn from settlement, location, sale, or entry, and reserved for public use in accordance with the provisions of section 10 of the Act of December 29, 1916 * * *, and in aid of pending legislation.

Had Congress supposed that it had theretofore authorized those persons permissively using the public lands for stock grazing to acquire private ownership of the right to use the waters of the springs and water holes, it is to be assumed that in authorizing the reservation "for public use" of the lands containing "water holes or other bodies of water needed or used by the public for watering purposes" it would have excepted such sources theretofore appropriated. It is therefore highly significant that no

such exception was made either by Section 10 of the 1916 Act or by the 1926 Executive Order implementing the authority thereby granted.

Absent a right in the public property, appellant's occupation was plainly illegal and the United States was entitled to an injunction preventing such continued violation of law. United States v. Langendorf, 322 F.2d 25 (C.A. 9, 1963); cf. Beay v. United States, F.2d (C.A. 9, 1965). 4/

CONCLUSION

The judgment of the district court is correct and shoul be affirmed.

Respectfully submitted,

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NOVEMBER 1965

4/ Copies of this unreported opinion are transmitted with this brief to counsel for appellant.

CERTIFICATE OF EXAMINATION OF RULES

I certify that I have examined the provisions of Rules 18 and 19, C.A. 9, and that in my opinion the tendered brief conforms to all requirements.

CARL L. SANDSTROM
Attorney, Department of Justice
Washington, D. C., 20530

APPENDIX

(1) Presidential Proclamation No. 2028, February 11, 1933, 47 Stat. 2554.

DEATH VALLEY NATIONAL MONUMENT -- CALIFORNIA

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

WHEREAS it appears that the public interest would be promoted by including certain lands known as Death Valley, in California, within a national monument for the preservation of the unusual features of scenic, scientific, and educational interest therein contained:

NOW, THEREFORE, I, HERBERT HOOVER, President of the United States of America, by virtue of the power in me vested by section 2 of the act of Congress entitled "AN ACT For the preservation of American antiquities," approved June 8, 1906 (34 Stat. 225), do proclaim and establish the Death Valley National Monument and that, subject to all valid existing rights, the area indicated on the diagram hereto annexed and forming a part hereo

be, and the same is hereby, included within the said national monument.

Warning is hereby expressly given to all unauthorized persons not to appropriate, injure, destroy, or remove any feature of this monument and not to locate or settle upon any of the lands thereof.

The Director of the National Park Service, under the direction of the Secretary of the Interior, shall have the supervision, management, and control of this monument as provided in the act of Congress entitled "AN ACT To establish a National Park Service, and for other purposes," approved August 25, 1916 (39 Stat. 535-536), and acts additional thereto or amendatory thereof.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the seal of the United States to be affixed.

DONE at the City of Washington this 11" day of

[SEAL] February, in the year of our Lord nineteen hundred and thirty-three, and of the Independence of the United States of America the one hundred and fifty-seventh.

HERBERT HOOVER

By the President:
Henry L. Stimson
Secretary of the State.

[No. 2028]

(2) Act of August 25, 1916, 39 Stat. 535, as amended (16 U.S.C. sec. 3)

The Secretary of the Interior shall make and publish such rules and regulations as he may deem necessary or proper for the use and management of the parks, monuments, and reservations under the jurisdiction of the National Park Service, and any violation of any of the rules and regulations authorized by this section and sections 1, 2, 4, 22, and 43 of this title shall be punished by a fine of not more than $500 or imprisonment for not exceeding six months or both, and be adjudged to pay all costs of the proceedings. He may also, upon terms and conditions to be fixed by him, sell or dispose of timber in those cases where in his judgment the cutting of such timber is required in order to control the attacks of insects or diseases or otherwise conserve the scenery or the natural or historic objects in any such park, monument, or reservation. He may also provide in his discretion for the destruction of such animals and of such plant life as may be detrimental to the use of any of said parks, monuments, or reservations. He may also grant privileges, leases, and permits for the use of land for the

accommodation of visitors in the various parks, monuments, or other reservations provided for under section 2 of this title, but for periods not exceeding thirty years; and no natural curiosities, wonders, or objects of interest shall be leased, rented, or granted to anyone on such terms as to interfere with free access to them by the public: Provided, however, That the Secretary of the Interior may, under such rules and regulations and on such terms as he may prescribe, grant the privilege to graze livestock within any national park, monument, or reservation referred to in this section and sections 1, 2, 4, 22, and 43 of this title when in his judgment such use is not detrimental to the primary purpose for which such park, monument, or reservation was created, except that this provision shall not apply to the Yellowstone National Park: And provided further, That the Secretary of the Interior may grant said privileges, leases, and permits and enter into contracts relating to the same with responsible persons, firms, or corporations without advertising and without securing competitive bids: And provided further, That no contract, lease, permit, or privilege granted shall be assigned or transferred by such grantees, permittees, or licensees without the approval of

the Secretary of the Interior first obtained in writing: <u>And provided further</u>, That the Secretary may, in his discretion, authorize such grantees, permittees, or licensees to execute mortgages and issue bonds, shares of stock, and other evidences of interest in or indebtedness upon their rights, properties, and franchises, for the purposes of installing, enlarging or improving plant and equipment and extending facilities for the accommodation of the public within such national parks and monuments. (Aug. 25, 1916, ch. 408, §3, 39 Stat. 535; June 2, 1920, ch. 218, §5, 41 Stat. 732; Mar. 7, 1928, ch. 137, §1, 45 Stat. 235; May 29, 1958, Pub. L. 85-434, 72 Stat. 152.)

(3) Act of July 26, 1866, 14 Stat. 253, 43 U.S.C. sec. 661 (1st paragraph)

Whenever, by priority of possession, rights to the use of water for mining, agricultural, manufacturing, or other purposes, have vested and accrued, and the same are recognized and acknowledged by the local customs, laws, and the decisions of courts, the possessors and owners of such vested rights shall be maintained and protected in the same; and the right-of-way for

the construction of ditches and canals for the purposes herein specified is acknowledged and confirmed; but whenever any person, in the construction of any ditch or canal, injures or damages the possession of any settler on the public domain, the party committing such injury or damage shall be liable to the party injured for such injury or damage.

(4) Act of July 9, 1870, 16 Stat. 218, 43 U.S.C. sec. 661
(2d paragraph)

All patents granted, or preemption or homesteads allowed, shall be subject to any vested and accrued water rights, or rights to ditches and reservoirs used in connection with such water rights, as may have been acquired under or recognized by section 51 of this title.

(5) 36 Code of Federal Regulations Section 1.20

a. The running at large, herding, driving across, or grazing of livestock of any kind on the Government lands in the parks and monuments, or the use of such lands for agricultural purposes, is prohibited, except where authority therefor has

been granted pursuant to a revocable permit issued by an authorized officer or employee of the National Park Service. Applications for such authorization may be addressed to the superintendent of the area involved.

Section 1.91

a. Any person who violates any provision of the rules and regulations in this chapter, or as the same may be amended or supplemented, in regard to any national park or monument not specified in paragraph (b) or (c) of this section shall be deemed guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not more than $500 or imprisonment for not exceeding 6 months, or both, and be adjudged to pay all costs of the proceedings.

(6) Rule 65, Federal Rules of Civil Procedure

(d) FORM AND SCOPE OF INJUNCTION OR RESTRAINING ORDER.

Every order granting an injunction and every restraining order shall set forth the reasons for its issuance; shall be specific in terms; shall describe in reasonable detail, and not

by reference to the complaint or other document, the act or acts sought to be restrained; and is binding only upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise.

No. 20,091

United States Court of Appeals

For the Ninth Circuit

Universal Underwriters Insurance Company, a corporation, *Appellant,* vs. American Motorists Insurance Company, a corporation, *Appellee.*	}

BRIEF FOR APPELLANT

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ERNAU-WALSH PRINTING CO., SAN FRANCISCO

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No. 20,091

United States Court of Appeals

For the Ninth Circuit

UNIVERSAL UNDERWRITERS INSURANCE COMPANY, a corporation, *Appellant,* vs. AMERICAN MOTORISTS INSURANCE COMPANY, a corporation, *Appellee.*	

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a Judgment entered on March 3, 1965, by the United States District Court for the Northern District of California, Northern Division. The underlying action was brought by appellant Universal Underwriters Insurance Company (hereinafter referred to as Universal), a corporation, against American Motorists Insurance Company (hereinafter referred to as American), a corporation. The amount in controversy exceeded $10,000.00. The District Court's jurisdiction was invoked under 28 USC Section 1332, inasmuch as Universal is a citizen of the State of Missouri with its principal place of business and home office in the State of Missouri, and

American is a corporation duly organized and existing under and by virtue of the laws of the State of Illinois, is a citizen thereof, and has its principal place of business and home office in the State of Illinois. On March 10, 1965, appellant, Universal, filed a timely Notice of Appeal. This Court's jurisdiction accordingly rests on 28 USC Section 1291.

STATEMENT OF THE CASE

This is a suit by Universal to force American to reimburse Universal for all of its out-of-pocket expenses incurred while paying a compromise settlement to one Vickie Graf, a minor for Miss Graf's injuries. Universal in fact compromised Miss Graf's claim (at a figure conceded to be reasonable by American) and in this action seeks recovery of all sums paid to the guardian ad litem of Miss Graf together with all of its expenses incurred in connection with the defense of that action.

The basic facts underlying this suit are as follows, all of which are set forth in the Stipulation As To Certain Facts and Testimony of Witnesses filed with the trial court except as noted:

The principal parties to this action, i.e., Universal and American are insurance companies. At all times pertinent here, Universal insured under a policy, an exact copy of which was received by the trial court, a partnership known as "K. B. McCarthy" consisting of K. B. McCarthy, George Little, Royal E. McCar-

thy, and Floyd Todd. The partnership was engaged in the business of selling new and used automobiles with its principal place of business in Eureka, California.

At all times pertinent herein, American insured Crocker-Anglo National Bank, a national banking association, under a policy of insurance, an exact copy of which was received by the trial court.

On August 6, 1957, the partnership McCarthy (hereinafter referred to as "McCarthy") sold a new 1957 Dodge to one Cecil Wolf pursuant to a Conditional Sales Contract. McCarthy thereupon assigned the contract to Crocker-Anglo National Bank (hereinafter referred to as "Bank") and guaranteed the contract with recourse. Following the execution of the contract, the Dodge was registered with the Department of Motor Vehicles of the State of California with Wolf as the registered owner and Bank as the legal owner. The registration remained this way until June 30, 1958.

Prior to April 22, 1958, Wolf had defaulted on his contract. On April 22, 1958, Bank turned the account over to one Joseph Sheiber, who operated an independent collection agency in Eureka, California and retained him for its account to repossess this vehicle. On April 23, 1958 Sheiber repossessed the Dodge and delivered it directly to McCarthy at its place of business. McCarthy did not pay Bank until June 30, 1958, so that at the time of the episode in question (May 4, 1958) McCarthy was neither the registered nor legal owner.

On May 4, 1958, the Dodge, while being driven by Eris McCarthy, struck and injured a four year old girl, one Vickie Graf. Eris McCarthy is the wife of Royal E. McCarthy, one of the partners of "K. B. McCarthy". At the time of the accident Eris was driving the Dodge with the permission of the partnership McCarthy for her own personal use and not in the course or scope of McCarthy's business. (Findings of Fact No. 10.) Subsequent to the accident an action was filed on behalf of Vickie Graf by her guardian ad litem in the Superior Court of the State of California, in and for the County of Humboldt. An exact copy of the Complaint in that action was received by the trial Court. Upon service of the Summons and Complaint, McCarthy turned them over to Universal, who after making demand (which was refused) on American that it defend the action, defended Eris McCarthy in said action.

On February 1, 1960, Universal pursuant to valid Court Order approving the compromise paid \$15,000.00 to the child's guardian ad litem in settlement of the suit filed by the guardian against Mrs. McCarthy. American concedes that the amount of the settlement was reasonable. In addition, Universal incurred expenses in said action in the sum of \$1,746.92, which were reasonable.

In its complaint in this action Universal contended that American was required to reimburse it for the \$15,000.00 settlement together with all of its out of pocket expenses incurred in the defense of that action. On March 3, 1965, the District Court entered Judg-

ment in favor of American and decreeing that Universal recover nothing.

This appeal followed.

SPECIFICATION OF ERRORS RELIED ON

1. The District Court erred in granting Judgment in favor of American and in denying the relief for which Universal prayed.

2. The District Court erred in holding that Eris McCarthy was not insured at the time under the American Motorists policy and further erred in not holding that said policy provided primary coverage to her.

3. The District Court erred in failing to find expressly that Eris McCarthy was driving the subject vehicle with the permission of the Bank.

SUMMARY OF ARGUMENT

The District Court found (and properly so) that at the time of the episode, Bank was the owner of the 1957 Dodge driven by Eris McCarthy. (See Findings of Fact No. 12.) Accordingly, Eris McCarthy was covered under American's policy for her liability, if any. Coverage was afforded under the "Definition of Insured" (Insuring Agreements III "definition of insured" contained in the American policy) because she had the implied permission of Bank to drive the vehicle. While it is true that Eris McCarthy was

also covered by the policy issued by Universal at said time and place, the coverage afforded by American is primary because of the language of the two "other insurance" clauses in the respective policies. The American policy (Paragraph XIV of "Conditions" of the American policy) provides that any liability under that policy is prorated with any other "valid and collectible insurance" in the event two policies cover an assured. The applicable portion of the Universal policy provides that any insurance afforded thereby is excess over any other valid and collectible insurance that is available in the event of dual coverage. Consequently, the insurance provided by American is primary, and it is required under the applicable law to reimburse Universal for the amounts paid by settlement and, in addition, to reimburse Universal for all of the expenses incurred by it in the defense of the injury action.

I. PREAMBLE.

California law is clear that in determining whether an insurance policy provides coverage, the Court must resolve all doubts in favor of the insured, and construe any ambiguities most strongly in favor of the assured and against the insurer. See *Continental Insurance Company v. Zurich Insurance Company* (1961) 57 C. 2d 27, 366 P. 2d 455.

Obviously, in this matter either or both policies could provide coverage to Eris McCarthy. Consistent with the above policy, in making a determination

whether a given insurance policy provided coverage, the Court should assume that it was the only policy in existence and thus must resolve all doubts in Eris McCarthy's policy. In short, in determining whether Eris McCarthy was covered by the American Motorist policy at the time of the episode, she is entitled to have all the ambiguities in the policy construed in her favor. In making the determination of whether there was coverage by the American Motorists policy, the Court should assume that it is the only policy in existence which might provide coverage to her.

II. ERIS McCARTHY WAS AN INSURED UNDER THE AMERICAN MOTORIST POLICY.

This follows because Crocker-Anglo Bank, the named assured under that policy was the owner of the vehicle and Eris McCarthy was using it with the bank's permission.

A. The Insuring Clause.

The policy itself states that Crocker-Anglo National Bank is the named insured. Under the Definition of Insured (Insuring Agreements III, definition of insured) the policy provides in part: "The unqualified word insured includes the named insured and also includes any person while using an *owned* automobile —providing the actual use of the automobile is by the named assured or with his permission * * *" (emphasis added). Thus Eris McCarthy is insured under that policy if the following two conditions are met:

(a) Bank was the owner of the vehicle.

(b) She was driving it with permission and consent of Bank.

B. Crocker-Anglo was the Owner of the Automobile.

The District Court specifically found this to be the fact (see Findings of Fact No. 12). There is ample evidence to support this finding, among it the statement in the Dealer Plan Agreement entered into between McCarthy and Bank which was in effect at the time of the accident. Part V of the Dealer Plan Agreement reads as follows: "Until payment is made, such *vehicle* in the contract shall be and remain the property in subject to the order of the Bank" (emphasis added). This, among other evidence, clearly supports the District Court's finding.

C. Eris McCarthy Was Driving the Vehicle With the Permission and Consent of the Bank.

Eris McCarthy had the permission, both actual and implied in law to drive the subject vehicle. *Souza v. Corti* (1943) 22 C. 2d 454, 139 P. 2d 645 and *Hobbs v. Motor Transport Co.* (1943) 22 C. 2d 773, 141 P. 2d 738, both hold that under California law an inference that an owner delivered a car to a permittee with permission for the permittee to use the car for *all purposes* is drawn from the mere surrender of possession by the owner.

In this instance, the evidence clearly shows that Sheiber, the person who repossessed the vehicle did so for the account of and at the instructions of Bank. The evidence is uncontradicted that the car was deliv-

ered to McCarthy without any restrictions on the use of the vehicle. Moreover, the District Court specifically found that at the time of the accident in question, the partnership McCarthy was the "bailee" of the car and that Eris McCarthy was driving the vehicle with the partnership's permission. (See Finding of Fact No. 10.) Under those circumstances, the above cited authorities make it clear that under California law Eris McCarthy was driving the vehicle with the permission of the Bank, the bailor. There was no finding in trial court that any conditions were imposed by the owner Bank upon the use by McCarthy of the vehicle and, in fact, there was no evidence upon which such a finding could be based. In fact, there was no testimony at the trial that McCarthy's use of the vehicle was in any way, shape or form restricted or were there any circumstances from which one can find such restrictions. Bank's witnesses testified that Bank didn't care what McCarthy did with the car so long as he paid for it.

The case of *Stewart v. Norsigian* (1944) 64 C. A. 2d 540, 149 P. 2d 46, demonstrates in a similar case that a person driving a vehicle under these circumstances does so with the permission of the owner-bailor.

III. ERIS McCARTHY WAS NOT EXCLUDED FROM COVERAGE UNDER THE AMERICAN MOTORIST POLICY BY ANY OF THAT POLICY'S PROVISIONS.

A. The Purported Exclusion Contained in Insuring Agreements III, Definition of Insured (B), Does Not Apply.

Under that clause, coverage is denied to one otherwise covered if they are an agent or employee of an automobile sales agency, with respect to any accident arising out of the operation thereof. This coverage is lost *only* if the accident arises *out of the operation* of an automobile sales agency. The issue is whether the vehicle is being used for business or for pleasure. In this instance, it was being used for pleasure and Mrs. McCarthy was not deprived of coverage.

California law is settled that insurance policies are construed most strongly against the insurer and in favor of the insured. See *Steven v. Fidelity & Casualty Co.* (1962) 58 C. 2d 862, 377 P. 2d 284, and *Southwestern Funding Corp. v. Motors Insurance Corp.* (1963) 59 C. 2d 91, 378 P. 2d 361.

B. Restrictive Endorsement Contained in the Policy (The Fourth Endorsement), Purporting to Restrict the Insurance Only to the Named Insured With Regard to Repossessed Automobiles, Is Not Enforceable.

The California Supreme Court has flatly held that restrictive endorsements under no circumstances are enforceable in California. *Interinsurance Exchange v. Ohio Casualty Insurance Company* (1962) 58 C. 2d 142, 373 P. 2d 640; *Wildman v. Government Employees Insurance Co.* (1957) 48 C. 2d 31, 307 P. 2d 359.

This endorsement actually reinforces our conclusion that Eris McCarthy is in fact covered under the policy. Without that endorsement, there is no provision excluding repossessed automobiles, and thus, in the absence of such an endorsement, repossessed automobiles (and Eris McCarthy) would be covered. Then for an additional premium ($979.00) an endorsement purporting to limit coverage already provided is added which attempts to limit the coverage and eliminate some assureds. In short, the insurer is charging more money and attempting to cut down coverage. This ambiguity between the main body of the policy and the endorsement must be construed in favor of the insured and against the insurer. *Steven v. Fidelity & Casualty Co.*, supra, and *Southwestern Funding Corp. v. Motors Insurance Corp.*, supra.

IV. AS ERIS McCARTHY WAS AN INSURED UNDER THE MAIN BODY OF THE AMERICAN MOTORISTS POLICY, THE "OTHER INSURANCE" CLAUSE OF THAT POLICY REQUIRES A PRORATION WITH OTHER "VALID AND COLLECTIBLE INSURANCE", IF ANY APPLIED.

If Eris McCarthy is an assured under the American Motorists policy, Paragraph 14 of the "Conditions" provides that that policy's liability is prorated with any other "valid" and collectible insurance available to her.

V. THE ONLY INSURANCE PROVIDED TO ERIS McCARTHY UNDER THE UNIVERSAL UNDERWRITERS POLICY IS ENDORSEMENT A 20 F "USE OF OTHER AUTOS—BROAD FORM."

Eris McCarthy is not a named assured on the policy. The named assured is K. B. McCarthy, a partnership consisting of certain specified individuals (not she). The only place she is covered under the policy is under the quoted endorsement. Eris McCarthy was not covered under Paragraph III (Definition of Insured) in the Insuring Agreement Section of Universal Underwriters policy because she was not using an automobile owned by the named insureds, it being owned by Crocker-Anglo Bank.

VI. ENDORSEMENT A 20 F, UNDER THE UNIVERSAL UNDERWRITERS POLICY SPECIFICALLY STATES THAT ANY INSURANCE AFFORDED THEREBY IS EXCESS OVER ANY OTHER "VALID AND COLLECTIBLE" INSURANCE THAT IS AVAILABLE.

The endorsement so states.

VII. UNDER CALIFORNIA LAW, IF INSURANCE COVERAGE IS PROVIDED TO ONE PERSON BY TWO POLICIES, ONE OF WHICH CONTAINS A "PRORATE" CLAUSE (AS IN THE AMERICAN MOTORISTS POLICY) AND THE OTHER OF WHICH CONTAINS AN "EXCESS" CLAUSE (AS IN THE UNIVERSAL UNDERWRITERS POLICY) THE PRORATE POLICY IS PRIMARY AND THE EXCESS POLICY IS SECONDARY.

American Automobile Company v. Republic Indemnity Company (1959) 52 C. 2d 507, 341 P. 2d 675;

Continental Casualty Company v. Zurich Insurance Company (1961) 57 C. 2d 27, 366 P. 2d 455, both so hold.

Since the American Motorists policy had limits relating to this accident of Five Hundred Thousand Dollars ($500,000.00), it provided the sole protection to Eris McCarthy for this accident.

VIII. SINCE THE AMERICAN MOTORISTS POLICY WAS THE POLICY PROVIDING PRIMARY COVERAGE TO ERIS McCARTHY, UNIVERSAL UNDERWRITERS IS ENTITLED TO RECOVER ALL OF ITS EXPENSE INCURRED IN HER DEFENSE IN THE GRAF ACTION.

For a square holding to that effect (overruling a series of prior California contrary cases), see *Continental Casualty Company v. Zurich Insurance Company,* supra.

IX. THIS COURT'S HOLDING IN TRUCK INSURANCE EXCHANGE v. AMERICAN SURETY COMPANY OF NEW YORK (1964) 338 F. 2d 811 (C.C.A. 9) IS NOT CONTRARY TO ANY OF THE POSITIONS URGED IN THIS CASE.

The District Court erroneously believed that the finding in this case was governed by *Truck Insurance Exchange v. American Surety Company of New York* (1964) 338 F. 2d 811 (C.C.A. 9).

Without belaboring the facts of the *Truck Insurance* case, the distinction between that matter and ours is that in that action there were two concurrent tortfeasors each of whom was directly negligent and each of whom was covered *by one, and only one*

insurance policy, for his primary liability. Of key importance is the fact that neither of the tortfeasors was covered by two insurance policies for his primary liability, which is the situation with Eris McCarthy here.

In the *Truck Insurance* case, the trial court determined that Wescott, an employee of J & W Logging Company and owner of premises was directly negligent, and further had determined that J & W Logging Company was directly negligent itself in failing to provide a safe place to work. Thus the trial court concluded that there were two concurrent tortfeasors. This Honorable Court correctly held that Wescott was covered by the Truck Insurance Exchange Policy which had been then issued to the truck owner as he was "using" the truck. Thus Wescott was in fact provided coverage by the Truck Insurance Exchange policy. Of key importance, however, was the fact that the American Surety policy issued to *J & W* insured it only and did not provide coverage to its employees. Thus Wescott was covered only by the *Truck Insurance policy* and J & W was covered only by the American Surety policy, for their direct liabilities. Consequently, the distinction between that case and this.

In the *Truck Insurance* case this Honorable Court correctly holds that J & W would be liable vicariously for Wescott's independent negligence, and further holds that as to that liability J & W could recover individually from Wescott and that his insurance company stands in the same shoes. However, since

Wescott and J & W had equal primary liabilities, and each was covered by only one insurer therefor, it was proper to split the liability between the two carriers.

We certainly concede the validity of the trial court's statement in this case that the insurance carriers here are in no different position than their respective insureds. Here, however, there is only one person having direct liability for the injury and the question is which of two insurance policies provide coverage and in the event of dual coverage, which policy afforded primary coverage.

CONCLUSION

For the reasons stated, it is respectfully submitted that the District Court's action in granting Judgment to appellee and denying appellant's request for relief was erroneous and should be reversed and the cause remanded with instructions to enter Judgment on behalf of appellant for $16,746.92, representing the stipulated amount of the settlement plus its out-of-pocket expenses incurred in the defense of the Graf action.

Dated, Eureka, California,
October 4, 1965.

Respectfully submitted,
Hill & Hill,
Clayton R. Janssen,
Attorneys for Appellant.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Clayton R. Janssen,
Attorney for Appellant.

No. 20,091

United States Court of Appeals

For the Ninth Circuit

UNIVERSAL UNDERWRITERS INSURANCE COMPANY, a corporation,

Appellant,

vs.

AMERICAN MOTORISTS INSURANCE COMPANY, a corporation,

Appellee.

REPLY BRIEF FOR APPELLEE

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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No. 20,091

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UNIVERSAL UNDERWRITERS INSURANCE COMPANY, a corporation,

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Appellee.

REPLY BRIEF FOR APPELLEE

JURISDICTION

The jurisdictional statement of appellant is correct and is accepted by appellee.

STATEMENT OF FACTS

Under the caption of its brief, "Statement of the Case," appellant has purported to state the facts of this case. The facts are found in the parties' signed "Stipulation as to Certain Facts and Testimony of Witnesses," which is a part of the record and upon which, plus some additional testimony taken at the trial, the decision of the trial court is predicated.

Because appellee considers appellant's statement incomplete and perhaps slightly partisan, we presume to submit here for the court's assistance a more complete resume of the facts:

Eris McCarthy is the wife of Royal E. McCarthy. Royal E. McCarthy is one of three general partners doing business as K. B. McCarthy (said partnership is hereinafter referred to as McCarthy), a new and used car dealer in Eureka.

On August 6, 1957, McCarthy as vendor and Cecil Wolf as vendee entered into a conditional sales contract for the sale and purchase of a new 1957 Dodge automobile (hereinafter referred to as Dodge). McCarthy forthwith assigned the conditional sale contract to Crocker-Anglo National Bank (hereinafter referred to as Bank) and guaranteed same with recourse. Simultaneously with execution of the conditional sales contract, Wolf executed an irrevocable and non-cancelable "Authorization for Transfer and Delivery of Certificate of Ownership" which authorized and instructed Bank to (a) deliver the Certificate of Ownership for Dodge properly endorsed, *only* to McCarthy as soon as the conditional sales contract was satisfied, and (b) accept payment of the amount due under the conditional sales contract. The authorization notified Bank that release thereof must come from McCarthy, to whom Wolf's equity in the Dodge had been pledged as security for labor and/or materials installed therein. This authorization was never released to McCarthy. Dodge was registered in the

Department of Motor Vehicles with Wolf as registered owner and Bank as legal owner and remained that way until June 30, 1958.

By April 22, 1958, Wolf was delinquent in his payments. Bank turned the account over to Joseph Schieber, who operated an independent collection agency, with instructions to collect the two delinquent installments or one delinquent installment with a promise to pay the second delinquent installment. Wolf could not pay the delinquent installments, so Schieber repossessed the Dodge on April 23, 1958, and delivered possession of it to and received a receipt from McCarthy.

On April 24, 1958, McCarthy wrote Wolf advising him of the repossession, his liability for deficiency, for him to get in touch with McCarthy immediately, and that no action would be taken for five days. Wolf couldn't borrow the money to take the car back as requested by Royal E. McCarthy, relinquished the Dodge to McCarthy so it could be sold immediately and signed a power of attorney to transfer title to Dodge.

McCarthy performed reconditioning work on Dodge on April *26* and May *2*. McCarthy took Dodge into *stock* on April 29 as "Used Car 5019R."

On May 4, 1958, while Eris McCarthy was driving Dodge with express permission of Royal E. McCarthy, she was involved in an auto-pedestrian collision with Vicki Graf.

On June 30, 1958, McCarthy paid Bank balance due on the Wolf contract and received Dodge's certificate of ownership endorsed by Bank as legal owner. Also on June 30, 1958, B. Green, who was McCarthy's contract clerk, signed, pursuant to the power of attorney previously executed by Wolf, Dodge's certificate of ownership on behalf of Cecil Wolf as registered owner so as to transfer Dodge to Byrd Hey who purchased Dodge from McCarthy.

On December 31, 1957, Bank and McCarthy had entered into a dealer plan agreement which provided that upon default of any contract by purchaser, McCarthy would pay Bank the contract balance, less unearned discount; that upon such payment Bank would assign contract to McCarthy; that if Bank tenders possession of vehicle to McCarthy without receiving immediate payment, McCarthy as trustee will execute and deliver to Bank as entruster, upon request, a trust receipt; and that until such payment the vehicle shall be subject to order of Bank.

An action filed against Eris McCarthy as a result of the accident of May 4, 1958 was defended by appellent (hereinafter referred to as Universal) and subsequently compromised. In this action Universal seeks to recover from appellee (hereinafter referred to as American) its expenses in the defense of said action and the amount paid by it in compromise.

During the argument to follow reference to some facts not specifically mentioned in the foregoing statement may be necessary and such reference will then be made.

ERRORS RELIED ON BY APPELLANT

Appellant specifies numerically three errors on which it relies to seek a reversal of the judgment of the trial court: (1) that in granting judgment for appellee the court erred; (2) that the court erred in holding that Eris McCarthy was not primarily covered by American's insurance policy issued to Bank, and (3) the failure to find expressly that Eris McCarthy was driving the Dodge at the time of the accident with the permission of Bank.

Appellee disputes all of these claimed errors. In the argument to follow we will show that the judgment of the trial court is sustained by the evidence, not only on the theory adopted by the court, but also upon one or both of two other theories.

With respect to the third assigned error, it should be noted that in its "Memorandum and Order" the trial court said: "It will be assumed *arguendo* that such permission existed." The decision was, therefore, based upon permissive use which is equivalent to a finding.

SUMMARY OF REPLY ARGUMENT

The trial court's decision is upon the theory that Bank was, under the law set forth in its memorandum, the owner of the Dodge; that Eris McCarthy was operating the Dodge with Bank's permission ("assumed *arguendo*"); that McCarthy was a bailee who permitted another to drive the vehicle and is, therefore, deemed an "operator" (Sec. 17154 Calif.

Vehicle Code); that as between the owner (Bank) and the operator, the latter bears the burden of liability; that the insurance carriers here involved are in no different position than the respective insureds, and that Universal may not recover from American.

Upon the evidence before it the judgment of the trial court upon that theory is fully supported and sound. It should be noted that nowhere in appellant's brief is Section 17154 of the California Vehicle Code discussed or even mentioned. The applicability of the section to the facts is not challenged, nor could it be.

But, furthermore, it can be and should be convincingly demonstrated that the same evidence would support findings for a judgment on either one of two other theories, to wit: (1) that under the law McCarthy, and not the Bank, was the owner of the Dodge at the time of the accident; or (2) that at least McCarthy and Bank were co-owners of the Dodge. The judgment is sound and sustainable on either of these additional theories.

ARGUMENT

I. COMMENT ON APPELLANT'S PREAMBLE.

This is an action between two insurers—Universal seeks reimbursement from American for a loss and expense Universal incurred as the result of an action defended by Universal on behalf of Eris McCarthy.

It is not an action by a claimed insured against a claimed insurer. There is no reason as between

the two insurers to invoke principles of public policy ordinarily indulged between an insured and his insurer. The broad principles of liberal construction of insurance policies need not and should not be resorted to in a controversy between two insurers over the interpretation of their respective policies.

Appellant's preamble reveals that it is treating this as a controversy between Eris McCarthy and American, which it is not. Eris McCarthy is not a party to nor does she have the slightest interest in this case. The claim against her was defended and compromised by Universal, which it may have done as a volunteer if, as it contends, it had no obligation to do so.

In any event, the rules of construction of "ambiguities" against an insurer and of resolving all "doubts" against the insurer should not be applied in favor of another insurer.

II. THE JUDGMENT AND DECISION AS RENDERED ARE SOUND.

This point has been succinctly stated in the foregoing Summary of Reply Argument. It needs only some amplification.

The trial court believed the law as it viewed it required a finding that Bank was the owner of the Dodge. This was based entirely on vehicle registration procedures prescribed by the California Vehicle Code and their construction by decision. We will

later review this subject of ownership. But, accepting that finding and assuming that Eris McCarthy was operating the Dodge with Bank's permission, the lower court also found that McCarthy was a "bailee" of the vehicle under Section 17154 of the Vehicle Code of California, which at that time read:

> Bailee as operator. "If the bailee of an owner with the permission, express or implied, of the owner permits another to operate the motor vehicle of the owner, then the bailee and the driver shall both be deemed operators of the vehicle of the owner within the meaning of Sections 17152 and 17153."

The essence of the lower court's decision is found in the penultimate paragraph of its "Memorandum and Order," reading as follows:

> "Section 17150 provides only for owner's liability to injured parties. Sections 17152 and 17153 establish that an owner who is held liable under §17150 may recover from the operator. Section 17154 provides that a bailee who permits another to drive the vehicle with the express or implied permission of the owner is himself deemed an operator within the meaning of the aforesaid sections. As between the owner and the 'operator,' then the ultimate burden is to be borne by the operator. Accordingly, it would be anomalous to permit such an operator to recover from the owner for his liability (Cf. Truck Insurance Exchange v. American Surety Company of New York, 358 F.2d 811 [United States Court of Appeals for the Ninth Circuit, No. 19,137, November 13, 1964]), whether satisfied by payment

> on a judgment or settlement. The insurance carriers here are in no different position than their respective insureds."
>
> (The "Sections" referred to are those of the Vehicle Code of California).

As previously noted, Section 17154 of the California Vehicle Code is not discussed or even mentioned in appellant's brief and the applicability of the section to the facts of this case is not challenged. Of the trial court's memorandum-decision appellant states that: "The District Court erroneously believed that the finding in this case was governed by *Truck Insurance Exchange v. American Surety Company of New York.*" It is apparent that appellant is mistaken and that the court did not believe, erroneously or otherwise, that the cited case "governed" this case, but it does support the court's statement that it would be anomalous to permit an "operator" to recover from an "owner" for the former's liability, whether satisfied by payment on a judgment or settlement.

Perhaps this brief could end here, but there are other reasons for the affirmance of the judgment of the lower court which may be discussed.

III. OWNERSHIP OF THE VEHICLE.

As asserted in the Summary of Appellee's Argument, appellee contends that the evidence before the trial court and the applicable law would support the judgment for American upon the theory that Mc-

Carthy and not the Bank was the owner of the vehicle or that McCarthy and Bank were co-owners. In either case Universal could not recover. A look at the evidence and the law on this subject of ownership is indicated.

A certificate of registration pertaining to the transfer of title or any interest in a vehicle does not necessarily or conclusively establish true ownership. *(Davis v. Joseph,* 148 C.A.2d 899, 905; 307 P.2d 958.)

Wolf executed a power of attorney to transfer Dodge and relinquish all rights to McCarthy. This was a transfer of his rights as a conditional buyer, subject to Bank's rights to receive the balance due as assignee of the conditional sales contract. *(Bowden v. Bank of America,* 36 Cal.2d 406, 414; 224 P.2d 713; *Davies-Overland Co. v. Blenkiron,* 71 C.A. 690; 236 P. 179.)

It is presumed that things which a person possesses are owned by him and that a person is the owner of property from exercising acts of ownership over it. (Calif. Code Civil Procedure, Section 1963, subdivisions 11 and 12; *Hamilton v. Madison Auto Sales Co.,* 94 C.A.2d 619, 623; 211 P.2d 335.)

The Dodge was in possession of McCarthy from April 23, 1958 until delivered to Byrd Hey on June 30, 1958. During that time McCarthy exercised innumerable acts of ownership of Dodge: (1) on April 24 wrote Wolf telling him he should get in touch with them immediately and that McCarthy would wait five days from date of this letter before taking

action; (2) accepted power of attorney to transfer vehicle from Cecil Wolf; (3) on April 26, 1958 McCarthy lubricated the Dodge and repaired it; (4) on April 29, 1958 McCarthy took the Dodge into stock and numbered it "Used Car 5019R"; (5) on May 2, 1958, McCarthy again lubricated and repaired Dodge; (6) on May 3, 1958, Royal E. McCarthy drove Dodge home; (7) on May 4, 1958, Royal E. McCarthy gave Eris McCarthy permission to drive Dodge; (8) McCarthy sold Dodge to Byrd Hey; (9) McCarthy transferred Dodge to Byrd Hey on June 30, 1958 by signing Cecil Wolf's name pursuant to the power of attorney.

Bank had only a security interest by reason of being an assignee of the conditional sales contract. *(Bowden v. Bank of America, supra.)*

When McCarthy paid off the contract balance it did not use an affidavit of repossession to transfer the title, but confirmed its ownership by using the power of attorney.

McCarthy actually became the owner of Dodge immediately upon transfer from Wolf, but did nothing to secure a new registration of Dodge. McCarthy cannot take advantage of its own wrong in failing to have Dodge registered in its name as registered owner. *(Schmidt v. C.I.T. Corporation,* 14 C.A.2d 92 at 95; 57 P.2d 1016.)

If the foregoing facts fall short of establishing that McCarthy and not the Bank was the owner of the Dodge at the time of the accident, the least that

can be said is that McCarthy was a co-owner of the vehicle.

Co-ownership need not be created by mutual consent, but may arise by operation of law. *(Krum v. Malloy,* 22 Cal.2d 132; 137 P.2d 18.) Ownership or co-ownership of the vehicle by McCarthy would preclude recovery in this action by Universal against American, if indeed it be necessary to resort to either status to uphold the judgment. If this court agrees with the trial court's finding that McCarthy was a bailee of the vehicle, no further consideration of the subject of ownership of the vehicle will be necessary.

IV. PERMISSIVE USE OF VEHICLE.

Because of the assignment of error by appellant of the failure to find expressly that Eris McCarthy was driving the Dodge with the Bank's permission, a review of the record on that subject will dispel that claim of error.

The record reveals, and appellant concedes (Appellant's Brief, p. 9) that Eris McCarthy was driving with the express permission of Royal E. McCarthy, a general partner in McCarthy. If, as appellee believes, the record shows McCarthy and not the Bank was the owner of the Dodge, no further comment on this subject would be necessary.

In cases of co-ownership it is a question of fact whether the operation of the vehicle was with or without the consent, express or implied, of an owner who

was not personally participating in the operation in question. *(Krum v. Malloy, supra.)*

Express permission of the Bank is not claimed and evidence to support a finding of implied permission is noticeably lacking. There was no evidence Bank had any knowledge of any use of the Dodge after McCarthy obtained possession of it—the Bank only demanded, and eventually received, payment of the balance due it. There was no testimony of any custom of McCarthy to make personal use of repossessed vehicles as was done in the case of this Dodge.

Assuming co-ownership, one must remember the nature of the parties—the Bank as a financial institution and McCarthy as an automobile dealer. Used cars in stock of an automobile dealer are reasonably intended for sale. While it may not be unrealistic to imply permission to demonstrate the car to a prospective purchaser, such was not the case here. This was a case where the use of the Dodge was not for any mutual benefit of the co-owners. The use was not connected with the business activities or business benefit of McCarthy as an automobile dealer. The use of the Dodge was not one customarily found in the automobile business.

Since an automobile and its component parts and accessories depreciate by use, it is not reasonable to imply permission from the absent co-owner for the Dodge to be used and thus depreciated without any intended direct or indirect benefit accruing to this absent owner. No co-owner of a car which was being held for sale by a co-owner automobile dealer would

expect a partner and his family to use the car for their own personal necessities and conveniences.

If the finding that the Bank was the sole owner of the Dodge is sound, the facts still do not show, by implication or otherwise, permission of Bank for Eris McCarthy to operate the vehicle for her own personal use.

The dealer agreement between Bank and McCarthy specified that Dodge would be subject to order of Bank. Admittedly, Bank never gave any orders to McCarthy regarding Dodge. No testimony was produced to show any prior or subsequent orders which permitted operation of a repossessed vehicle for the personal use of the wife of a partner.

> "A voluntary deposit is made by one giving to another, with his consent, the possession of personal property to keep for the benefit of the former, or a third party. The person giving is called the depositor, and the person receiving is the depositary." (Civil Code, Sec. 1814.)

If Bank be the sole owner, delivery of Dodge to McCarthy and acceptance by McCarthy makes this a deposit with Bank the depositor and McCarthy the depositary.

A depositary may not use the thing deposited, or permit it to be used, for any purpose without the consent of the depositor. (See Sec. 1835, California Civil Code.)

The dealer agreement provided that Dodge should be held subject to the order of Bank. In the absence of any orders from Bank, McCarthy had no righ

to let Eris McCarthy use the Dodge. (Sec. 1835, Civil Code.) There was no evidence of any oral or written orders directing or permitting the use of the Dodge for the personal convenience or necessity of Royal E. McCarthy or Eris McCarthy.

V. THE INSURANCE POLICIES.

Consideration of the insurance policies issued by Universal and American is perhaps necessary because of the court's finding that the Bank was the owner of the Dodge and the assumption of the trial court that it was being operated by Eris McCarthy with Bank's permission; and also because of the contention of appellant that Eris McCarthy was an insured under American's policy, that American's policy was "primary" and provided the sole protection to her for the accident in question, and that Universal's policy was "excess" coverage only for her.

Universal's Policy.

Universal's policy issued to McCarthy contains Endorsement F 6735 UU which provides as here material:

> "Garage
>
> (Premises-Operations-Automobile)
>
> It is agreed that such insurance as is afforded by policy for Bodily Injury Liability and for Property Damage Liability applied to the hazard defined below, subject to the following provisions:

A. Hazard Defined.

The ownership, maintenance or use of the premises for the purpose of an automobile dealer, repair shop, service station, storage garage or public parking place, and all operations necessary or incidental thereto; and the ownership, maintenance or use of any automobile in connection with the above defined operations, and the occasional use for other business purposes *and the use for non-business purposes of (1) any automobile owned by or in charge of the named insured* and used principally in the above defined operations, and (2) *any automobile owned by the named insured in connection with the above defined operations for the use of* the named insured, *a partner therein*, an executive officer thereof, or *a member of the household of any such person.*

* * * *

B. Definition of Insured (Limited Additional Interests)

With regard to the Hazard Defined in this endorsement, the Definition of Insured Agreement of the policy is null and void and the following Definition of Insured applies:

The unqualified word 'insured' includes the named insured and also includes (1) any partner, employee, director or stockholder thereof while acting within the scope of his duties as such, and any person or organization having a financial interest in the business of the named insured covered by this policy, and (2) any partner or employee or director or stockholder thereof or a member of *the household of* the named insured or *such partner* or employee or director or stock-

holder, *while using an automobile covered by this policy* or when legally responsible for the use thereof, provided the actual use of the automobile is by the named insured or with his permission, and (3) any other person or organization legally responsible for the use thereof only while such automobile is operated by the named insured or any such partner or employee or director or stockholder or member of the household of the named insured or partner or employee or director or stockholder, provided the actual use of the automobile is by the named insured or with his permission.

* * * *" (Italics ours)

Responsive to the California Financial Responsibility Law, this policy bore a designation of the insured partners as K. B. McCarthy, Helen McCarthy, Royal McCarthy, *Eris McCarthy,* George E. Little, Patricia M. Little and Floyd Todd dba K. B. McCarthy; and K. B. McCarthy, Helen McCarthy, Royal McCarthy, *Eris McCarthy,* George E. Little and Patricia M. Little, *as individuals.* A certificate filed with the Department of Motor Vehicles certifies that the policy is applicable "to all motor vehicles * * * operated * * * by the employer * * *". Eris McCarthy is specifically named as an "employer" on the reverse of this certificate, the effect of which is that of an endorsement to the policy and controls over any other language in the policy itself.

The Dodge automobile was in charge of McCarthy and was being used for non-business purposes by Eris McCarthy. Consequently she is an insured under this

policy by the provisions of paragraph B(2) of the endorsement.

It is important to note that Endorsement F 6735 UU does not contain an "other insurance" clause. Neither does it incorporate by reference the "other insurance" clause found in paragraph 14 of the policy conditions. Endorsement F 6735 UU commences by saying:

> "It is agreed that such insurance as is afforded by the policy for Bodily Injury Liability and for Property Damage Liability applies to the hazard defined below, subject to the following provisions."

No provision following refers to or incorporates Policy Condition 14, which does contain an "other insurance" clause. It should be further noted that paragraph 3, Endorsement AL 6629h, "Use of Other Automobiles—Broad Form", has a specific "other insurance" clause. Endorsement L 6370e—"Individual as Named Insured" incorporates the "other insurance" clause found in Condition 14 of the policy. Endorsement OCC—Comprehensive General Automobile Liability Policy—states that "All other terms and conditions of this policy remain unchanged."

It is respectfully submitted that the "other insurance" clause of Policy Condition 14 was not intended to be and is not a part of Endorsement F 6735 UU because of the particular language contained in said endorsement applying the bodily injury liability subject to specific provisions which fail to refer or incorporate the provisions of Policy Condition 14, while

other endorsements either provide a specific "other insurance" clause or incorporate Policy Condition 14.

If there is any ambiguity in Universal's policy, it must be resolved against Universal. If there is a conflict between the endorsement and the body of the policy, the endorsement controls. *(Continental Casualty Company v. Phoenix Construction Company,* 46 Cal.2d 423, 430-1; 296 P.2d 801.)

It is submitted that Universal's policy, by reason of its failure to specify an "other insurance" clause in Endorsement F 6375 UU and being certified, makes Universal's primary coverage for the accident in question.

American's Policy.

By paragraph 6 of Declarations of this policy the automobiles *owned* by Bank are listed on the schedule. Nowhere in that schedule of 113 automobiles is the Dodge listed. Since Dodge is not a scheduled owned automobile, Eris McCarthy cannot claim coverage for driving an owned automobile described in the schedule of vehicles owned by Bank.

The only coverage in American's policy issued to Bank which could cover the Dodge is found in Endorsement No. 4, which provides:

> "In consideration of $979.00 (included) flat premium not subject to audit, it is understood and agreed that coverage is afforded for *repossessed* automobiles.
>
> "This insurance applies *only* to the *named insured.* The insurance shall be *excess* insurance

> over any other valid and collectible insurance available to the named insured against a loss covered hereunder." (Emphasis added.)

This is a special endorsement which extends *excess* coverage to Bank *only* for repossessed automobiles. As such a special endorsement, its language controls over the general provisions of the policy.

> "Where general and specific provisions of a contract deal with the same subject matter, the specific provisions, if inconsistent with the general provisions, are of controlling force." (*Continental Casualty v. Zurich Ins. Co.,* 57 Cal.2d 27 at p. 35; 366 P.2d 455.)

The "other insurance" clause (paragraph 14 of Conditions) of the general language of American's policy is superseded by the express language of Endorsement No. 4 providing only *excess* insurance. Further, the definition of "insured" found in paragraph III of the insuring agreements is likewise superseded by the express language of Endorsement No. 4 to afford this coverage *only* to Bank.

The courts have uniformly upheld the validity of excess coverage clauses. (See *Continental Cas. Co. v. Zurich, supra,* where the court imposed the primary liability upon Zurich and prorated the amount of the judgment over and above that coverage among the two *excess* policies; and *McConnell v. Underwriters at Lloyd's,* 56 Cal.2d 637 at 646; 365 P.2d 407, where the court held that Lloyd's *excess* policy did not attach until the primary had been exhausted.)

Concededly, the case of *Inter-Insurance Exchange v. Ohio Casualty Company,* 58 Cal.2d 142; 373 P.2d 640, and *Wildman v. Government Employees' Ins. Co.,* 48 Cal. 2d 31; 307 P.2d 359, hold that provisions in a policy purporting to exclude certain classes of permissive users are void as against public policy. Here there is *no exclusionary* language in Endorsement No. 4. Rather, Endorsement No. 4 *extends excess* coverage *only* to Bank for repossessed cars, something in addition to the other policy provisions because coverage would not otherwise be afforded under American's policy for repossessed automobiles.

An insurance company has the right to limit the coverage of a policy issued by it and when it has done so, the plain language of the limitation must be respected. *(Continental Casualty Co. v. Phoenix Construction, supra.)*

If Endorsement No. 4 could be considered void as against public policy under the *Wildman* and *Inter-Insurance Exchange* cases, then the policy should be read with said endorsement deleted. Such a reading shows no coverage for Dodge as an owned automobile and neither the Bank nor anyone else, including Eris McCarthy, has coverage for this incident under the American policy.

To extend Endorsement No. 4 by application of the *Wildman* and *Inter-Insurance Exchange* cases to afford coverage to Eris McCarthy would be to rewrite the insurance contract. But if rewritten to cover Eris McCarthy, still, by its express terms, it only affords *excess* coverage. Since Eris McCarthy had ample

basic or primary coverage under Universal's policy to pay the loss, the excess coverage of American does not come into effect.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the trial court in this case is sound and proper, that the court did not err in any of the respects claimed by appellant, and that the judgment should be affirmed by this honorable court.

Dated, San Francisco, California,
January 12, 1966.

Respectfully submitted,
Bacon, Mundhenk, Stone & O'Brien,
Wm. C. Bacon,
Wm. F. Stone,
Attorneys for Appellee.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Wm. C. Bacon,
Attorney for Appellee.

No. 20,087

IN THE

United States Court of Appeals

For the Ninth Circuit

WALTER JOHNSON, individually and as Secretary-Treasurer of DEPARTMENT STORE EMPLOYEES UNION, LOCAL 1100, etc., et al.,
Appellants,

vs.

RAPHAEL WEILL & COMPANY, INC., d/b/a THE WHITE HOUSE, etc., et al.,
Appellees.

On Appeal from the United States District Court for the Northern District of California, Southern Division

REPLY BRIEF FOR APPELLANTS

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IN THE

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On Appeal from the United States District Court for the Northern District of California, Southern Division

REPLY BRIEF FOR APPELLANTS

There are a number of comments that appellants wish to make with respect to statements and arguments made by appellees in their brief filed herein on August 9, 1965.

First, contrary to appellees' argument (Appellees' Brief, page 5), there can be no question that the denial by the district court of appellants' motion to remand is properly before this Court for review. The

question of removability is jurisdictional and therefore is before the Court for consideration once it appears that the case is properly before the Court for review of an appealable order. *Mayflower Industries v. Thor Corp.* (C.A. 3, 1950), 184 F. 2d 537; *Chicago, R.I. & P.R. Co. v. Stude* (C.A. 8, 1953), 204 F. 2d 116; *Hook v. Hook & Ackerman, Inc.* (C.A. 3, 1956), 233 F. 2d 180; 6 *Moore's Federal Practice,* § 54.08.

There is no merit to appellees' argument contained in their brief at pages 13-14, that the Labor Management Relations Act, although it includes trustees in bankruptcy as "persons" covered by the Act (29 U.S.C. 152(1)), does not extend to suits to compel arbitration under Section 301 (29 U.S.C. 185). Appellees urge that the definition of "person" as including a trustee in bankruptcy relates only to the use of that word in subchapter II of Chapter 7 of U.S. Code Title 29, whereas Section 301 appears in subchapter IV of the same Chapter 7. Appellees apparently overlook the express language in 29 U.S.C. 142, which provides as follows:

> "When used in this *chapter*—
> * * *
>
> (3) *The terms* 'commerce', 'labor disputes', *'employer',* 'employee', 'labor organization', 'representative', *'person',* and 'supervisor' *shall have the same meaning as when used in subchapter II of this chapter* as amended by this chapter." (Emphasis supplied.)

It is therefore obvious that the definitions of "employer" and "person" in Section 2(1) and (2) of the

Act (29 U.S.C. 152(1) and (2)) apply to all proceedings under the Act, including suits to compel arbitration brought in the federal courts under Section 301 or in state courts under state law by virtue of *Dowd Box v. Courtney,* 368 U.S. 502, 82 S. Ct. 519, 7 L. Ed. 2d 474.

Appellees also argue that the "employer" definition contained in Section 2(2) of the Act (29 U.S.C. 152 (2)) does not make reference to trustees in bankruptcy, and that inasmuch as Section 301 suits are between labor organizations and "employers", that section cannot apply to trustees in bankruptcy. (Appellees' Brief, page 14.) This argument fails to take into consideration the express language of the Section 2(2) definition of "employer" as including all forms of "persons", described in Section 2(1), acting as agents of an employer, whether they be "one or more individuals, labor organizations, partnerships, associations, corporations, legal representatives, trustees, trustees in bankruptcy, or receivers". (29 U.S.C. 152 (1).) Further, the "employer" definition is specific in its exclusions from employer status, and such exclusions do not include trustees in bankruptcy.

Therefore, trustees in bankruptcy are subject to suits to compel arbitration pursuant to the terms of applicable collective bargaining agreements. The specific application of the Labor Management Relations Act to trustees in bankruptcy makes the decisions upholding the power of Congress to vest jurisdiction over certain proceedings in forums other than the Bankruptcy Court of compelling significance. It also

removes appellees' only real argument which is that Congress meant to vest paramount jurisdiction in the NLRB, but not in the courts under Section 301. Thus, appellees' arguments that it is the bankruptcy court that has exclusive jurisdiction in these matters, citing Sections 2a(2) and 2a(7) of the Bankruptcy Act, *Ex Parte Baldwin,* 291 U.S. 610, 78 L. Ed. 1020, and *Thompson v. Magnolia Petroleum Co.,* 309 U.S. 478, 60 S. Ct. 628, 84 L. Ed. 876, and that the bankruptcy court will not surrender such jurisdiction except in unusual and exceptional circumstances, citing *Mangus v. Miller,* 317 U.S. 178, have no merit and cannot be regarded as controlling in the instant case. (Appellees' Brief, pages 10-11.) Rather, the decisions cited by appellants at page 19 of their opening brief, reflecting the courts' recognition of the principle that Congress has the power to vest in other forums jurisdiction over certain proceedings which may arise in the course of bankruptcy proceedings and the power to *require* that the bankruptcy court *qua* bankruptcy court surrender its jurisdiction to these other forums, are plainly controlling in the light of the specific Congressional intent manifested in the Labor Management Relations Act. There is, therefore, no question in this case regarding the *extent* or *character* of the discretion in the bankruptcy court or its *usual* powers *vis-a-vis* bankruptcy proceedings.

The question, instead, is which court is to be utilized by the aggrieved party to the collective bargaining agreement, i.e., the *state court* under the authority of *Dowd Box v. Courtney,* supra, or the *federal court*

under Section 301 of the Labor Management Relations Act (29 U.S.C. 185).

It thus becomes apparent that the decision in *In re Muskegon Motors Specialties Co.* (C.A. 6, 1963), 313 F. 2d 841, is not only erroneous for the reasons cited in appellants' Brief (page 16, footnote 5), but is inapposite to this case. That decision involved union claims in the federal district court that that court should have surrendered its jurisdiction *qua* bankruptcy court *in favor of arbitration.* Those are not the claims herein. Rather, appellants seek to enforce the Congressional intent manifested in the Labor Management Relations Act in providing the state courts and federal courts (not sitting as bankruptcy courts) as forums for the securing of available remedies, including arbitration, for violation of collective bargaining agreements. Although the union in *Muskegon,* supra, cited a number of cases which have been cited by appellants herein, the Court of Appeals for the Sixth Circuit in *Muskegon,* supra, held that they did not support the union's claim in favor of arbitration over the bankruptcy court. The Court stated:

> "In those cases, jurisdiction was surrendered either *to another court of competent jurisdiction* or to an administrative agency which was empowered by law to hear and determine the particular controversy." (Supra, at page 843; emphasis supplied.)

Appellants herein are seeking relief in "another court of competent jurisdiction", a right clearly given

them by the Labor Management Relations Act and its interpretation by the courts.

That the proper forum, i.e., the state court under state law (*Dowd Box v. Courtney,* supra) or the federal court under Section 301 may compel a trustee in bankruptcy to submit to arbitration is made clear by the LMRA and court decisions thereunder. The arbitration process is a creature of the Congressional intent as manifested in the Labor Management Relations Act, *Textile Workers Union v. Lincoln Mills,* 353 U.S. 448, 77 S. Ct. 912, 1 L. Ed. 2d 972; *United Steelworkers v. American Mfg. Co.,* 363 U.S. 564, 80 S. Ct. 1343, 4 L. Ed. 2d 1403; *United Steelworkers v. Enterprise Corp.,* 363 U.S. 593, 80 S. Ct. 1358, 4 L. Ed. 2d 1424; *United Steelworkers v. Warrior & G. Nav. Co.,* 363 U.S. 574, 80 S. Ct. 1347, 4 L. Ed. 2d 1409; *Order of Railway Conductors v. Pitney,* 326 U.S. 561, 66 S. Ct. 322, 90 L. Ed. 318 (adjustment board under the Railway Labor Act), as well as being consensual in nature. *Retail Clerks Local 770 v. Thriftimart Inc.,* 59 C. 2d 421, 380 P. 2d 385.

The decision in *Republic Steel v. Maddox,* 379 U.S. 650, 85 S. Ct. 614, 13 L. Ed. 2d 580 makes amply clear the necessity for the arbitration machinery even though at some future date the employer-party to the collective bargaining agreement ceases operations and files a petition in bankruptcy. Appellees argue that the employer could not be concerned at the contract negotiations stage about remedies available to the union in the event of the corporation's ultimate bankruptcy since it no longer has any interest in the

union's claim. (Appellees' Brief, page 18.) Appellees' argument thus is one of hindsight, that is, from the bankruptcy stage back to the contract negotiations. Such an approach is unrealistic and fails to take into consideration the nature of collective bargaining negotiations, to wit, to agree in writing to provide for every possible contingency in the future. The question thus is one of foresight and forecast, not hindsight. That this is the recognized function and status of collective bargaining contract negotiations is made clear by the courts when, with reference to arbitration, the contract is held to govern every contingency and every dispute or grievance *not specifically excluded* from arbitration coverage by the contract itself. In *United Steelworkers v. Warrior & G. Nav. Co.,* supra, the Supreme Court declared:

> "Arbitration is the means of solving the *unforeseeable* by molding a system of private law *for all the problems which may arise* and to provide for their solution in a way which will generally accord with the variant needs and desires of the parties.
>
> * * *
>
> Apart from matters that the parties *specifically exclude, all* of the questions on which the parties disagree must therefore come within the scope of the grievance and arbitration provisions of the collective bargaining agreement . . ." (Supra, at 4 L. Ed. 2d pp. 1416-1417; emphasis supplied.)

It is clear from the collective bargaining agreements contained in the record on this appeal that there is no specific exclusion from the arbitration process of

those disputes arising under the contract upon the contingency of bankruptcy.

The *Maddox* case, supra, bears out this philosophy. Justice Harlan, speaking for the U. S. Supreme Court, made this point:

> "Only in the situation in which no employees represented by the union remained employed, as would be the case with a final and permanent plant shutdown, is there no possibility of a work stoppage resulting from a severance-pay claim. *But even in that narrow situation, if applicable law did not require resort to contract procedures, the inability of the union and the employer at the contract negotiation stage to agree upon arbitration as the exclusive method of handling* permanent shutdown severance *claims in all situations could have an inhibiting effect on reaching an agreement.*" (Supra, 13 L. Ed. 2d at p. 585; emphasis supplied.)

Thus, if arbitration and contract procedures could be erased simply by the filing of a petition in bankruptcy, the congressional policy in favor of collective bargaining and the negotiation of agreements leading to industrial stabilization would be stultified at the bargaining table, at the very beginning of the collective bargaining process.

Appellees' argument that because complicated issues on the merits exist in the instant case any arbitration proceedings would be time-consuming and expensive is as irrelevant as it is untrue. (Appellees' Brief, page 19.) The arbitration process is what the parties contracted for and the fact that issues involved may

be complicated does not excuse the avoidance of the process. Actually, the arbitration tribunal is expressly created and designed to expedite the resolution of controversies in as least costly a manner as possible. These are the very reasons why the parties agree to the arbitration process as opposed to the more expensive and time-consuming machinery of the courts.

Appellees' assertion that an award by an arbitrator would be reviewable only to an "extremely limited extent" (Appellees' Brief, page 21) indicates an erroneous interpretation of federal labor law. Clearly, the court's role is very limited in deciding whether this or that grievance should be submitted to arbitration. It is confined to ascertaining whether the party seeking arbitration is making a claim which on its face is governed by the contract. *United Steelworkers v. American Mfg. Co.,* supra. However, this is not the point at issue here. The question of the extent of review of an arbitrator's decision or award is an entirely different matter. An arbitrator "does not sit to dispense his own brand of industrial justice". (*United Steelworkers v. Enterprise Corp.,* supra, 4 L. Ed. 2d at p. 1428.) His award is legitimate so long as it draws its essence from the collective bargaining agreement. When his words manifest an infidelity to this obligation, courts have no choice but to refuse enforcement of the award. (Id. at p. 1428.)

It is also clear that the bankruptcy court has a reviewing power over all judgments from other courts as well as all claims coming to it, although that reviewing power would be, of course, narrower than any

procedure amounting to a trial in the bankruptcy court itself. *Nathanson, Trustee v. NLRB,* 344 U.S. 25, 73 S. Ct. 80, 97 L. Ed. 23; *Adams v. Champion,* 294 U.S. 232, 79 L. Ed. 880.

Appellees also argue, in an apparent attempt to derogate from the merits of appellants' trust and other claims, that no injunction should have been issued by the Honorable Joseph Karesh of the Superior Court in and for the City and County of San Francisco, nor should it now be issued or permitted to be issued by this Court (Appellees' Brief, pages 22-29). As stated in appellants' opening Brief, at page 24 thereof, this question need not be decided by this Court since it is properly a matter for the appropriate forum in the exercise of its inherent equitable powers to protect its orders. Appellees urge that the decisions in *McKey v. Paradise,* 299 U.S. 119, 81 L. Ed. 75, *Schuyler v. Littlefield,* 232 U.S. 707, 58 L. Ed. 806, and *Adams v. Champion,* 294 U.S. 232, 79 L. Ed. 880, clearly indicate that appellants' assertions have no validity on their merits. This is not pertinent on this appeal and, in fact, would be improper for this Court to decide in the light of *United Steelworkers v. Warrior & G. Nav. Co.,* supra, and *United Steelworkers v. Enterprise Corp.,* supra. These cases clearly reject the doctrine that courts may pass on the merits of claims subject to arbitration under collective bargaining agreements.

It is, however, noteworthy that the facts of the instant case are significantly different from those in *McKey v. Paradise,* supra, and *Adams v. Champion,*

supra. It is clear that the instant matter does not involve agreement between the employer and the unions, as in those cases, to *withhold part of the wages of each employee* for payments to the pension plan, and there is thus no basis for a conclusion that the facts here involve merely a debt not paid by the employer. Rather, as is admitted by appellees in their Brief (page 24), there was a specific and enforceable trust created by the parties to the collective bargaining agreement and it is, in part, the existence of this trust and the failure of the employer to make payments thereto for which appellants seek relief. See also the footnote to page 24 of appellants' opening Brief.

Similarly, the decisions in *United States v. Embassy Restaurant,* 359 U.S. 29, 79 S. Ct. 554, 3 L. Ed. 2d 601, and *NLRB v. Deena Artware* (C.A. 6, 1953), 207 F. 2d 798, are distinguishable on their facts and are prematurely asserted since they are used in an attempt to move this Court to decide appellants' claims on their merits. Contrary to appellees' assertions, on page 28 of their Brief, that appellants are seeking herein a priority status over other creditors although they are unable to establish that a trust existed, the facts are that appellants have brought suit in the state court to submit these questions to arbitration. The existence of a trust resulting from the pension plan agreement, and any attendant priority status of pension benefits due the beneficiaries will be determined from that arbitration and the presentation of the arbitrator's award to the bankruptcy court,

much in the same manner as a state court judgment establishing a trust and the enforcement of that judgment in the bankruptcy court.

NLRB v. Deena Artware, supra, cited in Appellees' Brief at page 29, is particularly inapposite for several reasons. There, the claims involved were for *back wages* for improperly discharged employees that were reinstated by the NLRB. It is clear that those claims are not lien claims under the Bankruptcy Act. This is not the situation in the case at bar. Here, the question involves a trust and its enforcement. Further, the NLRB's rationale was that an injunction should issue to prevent contempt of the court's order of enforcement of reinstatement with back pay, and the Court of Appeals refused to assume that the employer would act in contempt at some distant time in the future. In the instant case, the employer is already in bankruptcy and has turned over its assets to the bankruptcy court. Thus, not only are the cases cited by appellees prematurely raised in this Court but they are distinguishable on their facts.

Appellees make two seemingly inconsistent statements with regard to what they contend appellants must do to protect their rights. They urge that the "exclusive remedy of a trust claimant is to file a petition in reclamation" (Appellees' Brief, page 10) and then go on to argue that appellants could "protect their position by filing a contingent claim in the bankruptcy proceedings while reserving their right to have the matter adjudicated by arbitration." (Appellees' Brief, page 23.)

It is clear beyond doubt that appellants may utilize other methods and procedures than those urged by appellees. In *First National Bank in Wichita v. Luther* (C.A. 10, 1959), 217 F. 2d 262, certain trust claimants utilized a petition in equity for the establishment and enforcement of a constructive trust on funds in the hands of the trustee in bankruptcy. Similarly, in the case at bar the appellants have sought arbitration of certain questions, including the establishment and enforcement of a trust, through a suit to compel arbitration in the state court, a right given to them by *Dowd Box v. Courtney,* supra.

The *First National Bank,* case, supra, is significant for another reason. Appellees assert that appellants should file a "contingent claim" in the bankruptcy court, within the meaning of Section 57 of the Bankruptcy Act. (11 U.S.C. 93.) Subsection (n) of that section provides that all such claims, including contingent claims, must be filed within six months after the first date set for the first meeting of creditors or they shall not be allowed. The court in the *First National Bank* case, supra, stated:

> ". . . The statute [Section 57 and particularly subsection (n) thereof relating to the six month filing period] is confined in its application to claims or like pleadings filed in which the relationship between the claimant or petitioner and the bankrupt is that of debtor and creditor . . . The pleading filed [to impress a trust] was not a claim of that kind . . ." (Supra, at page 265.)

It must be concluded, therefore, that the appellants have proceeded thus far in a proper fashion in seeking

arbitration by suit in the state court and are not restricted to those procedures urged as exclusive by appellees. It may well be that appellants will take further steps to protect their interests by the filing of claims in the bankruptcy court. This, however, does not affect the merits of appellants' contentions or imply that appellants have proceeded in an erroneous manner.

With respect to the jurisdictional question involved in the denial of appellants' motion to remand, appellees apparently miss completely the thrust of appellants' arguments when they state at page 32 of their Brief that "(a)ppellants argue that removal is not permitted where such concurrent jurisdiction exists, but that removal would only be permissible where exclusive jurisdiction is in the federal courts." It would be ludicrous for appellants to make such a suggestion and none has been made. Appellants have established, rather, that an action to compel arbitration, brought in a state court under state-created rights, is not one "founded on a claim or right arising under the Constitution, treaties or laws of the United States" so as to make it removable within the terms of § 1441(b) of the U. S. Removal Statute. (28 U.S.C. § 1441(b).)

Appellees assert that the decision of the U. S. Supreme Court in *Dowd Box v. Courtney,* supra, although affirming the right of the state courts to entertain actions for violation of collective bargaining agreements, makes it clear that Congress has preempted the field in this area and that, therefore, a state court suit is one arising under Section 301 of the

LMRA. Appellees further cite the California Supreme Court decision in *Retail Clerks Local 770 v. Thriftimart*, 59 C. 2d 421, 380 P. 2d 652 in support of this assertion. It is clear beyond doubt that *Dowd Box v. Courtney*, supra, indicates just to the contrary: that Congress has not preempted the field in this area but, rather, state courts have jurisdiction to act under their own laws. Both cases cited, *Dowd Box* and *Thriftimart*, simply recognize that substantive principles of federal labor policy are to be utilized by the state courts. In *Thriftimart*, supra, Justice Traynor declared that "this litigation is within the purview of Section 301 (a) . . ." (at p. 423.) This is by no means to say that such actions are founded on a claim or right arising under the Constitution, treaties or laws of the United States so as to make those actions removable to the federal courts. Thus, the arguments asserted by appellants and the decisions cited by them, including *Shultis v. McDougal*, 225 U.S. 561, 32 S. Ct. 704, 56 L. Ed. 1205; *Gully v. First National Bank in Meridian*, 299 U.S. 109, 57 S. Ct. 96, 81 L. Ed. 70, and *American Petroleum Corp. v. Superior Court of Delaware*, 366 U.S. 656, 81 S. Ct. 1303, 6 L. Ed. 2d 584, must, therefore, be regarded as plainly controlling. (Appellants' Brief, pages 29-36.)

It should be noted also that appellees' argument to the effect that this Court may look to the petition for removal to determine the "interstate commerce" status of the parties (Appellees' Brief, page 33) is quite unnecessary since appellants specifically rely on that status in their presentation of the questions

before this Court for determination (Appellants' Brief, page 7). The validity, however, of that portion of the decision in *Fay v. American Cystoscope Makers* (S.D. N.Y. 1951), 98 F. Supp. 228, cited by appellees, which states that Section 301 (29 U.S.C. 185) did not leave intact a separate and independent state cause of action because Congress *preempted the field* is no longer the law by reason of the holding in *Dowd Box v. Courtney,* supra. In fact, the validity of the removal holding in *Fay* was specifically questioned by the U. S. Supreme Court in the light of its decision in *Dowd Box v. Courtney,* supra. (See Note 8, 368 U.S. at page 514.)

Dated, San Francisco, California,
August 19, 1965.

Respectfully submitted,

CARROLL, DAVIS, BURDICK & McDONOUGH,
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Attorneys for Appellants.

No. 20,087

IN THE

United States Court of Appeals

For the Ninth Circuit

WALTER JOHNSON, individually and as Secretary-Treasurer of DEPARTMENT STORE EMPLOYEES UNION, LOCAL 1100, etc., et al.,
Appellants,

vs.

RAPHAEL WEILL & COMPANY, INC., d/b/a THE WHITE HOUSE, etc., et al.,
Appellees.

On Appeal from the United States District Court for the Northern District of California, Southern Division

BRIEF FOR APPELLEES JOHN M. ENGLAND, C. E. STROBEL AND WALTER J. HEMPY, TRUSTEES IN BANKRUPTCY OF RAPHAEL WEILL & CO., INC.

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On Appeal from the United States District Court for the Northern District of California, Southern Division

BRIEF FOR APPELLEES

JOHN M. ENGLAND, C. E. STROBEL AND WALTER J. HEMPY, TRUSTEES IN BANKRUPTCY OF RAPHAEL WEILL & CO., INC.

STATEMENT OF THE CASE

On January 26, 1965, appellants herein, through their attorney, Robert P. Cowell, Esq., sent to George Bahrs, Esq., attorney for Raphael Weill & Co., Inc., d/b/a The White House (herein called "The White House") a letter (R. 14-15), in which the appellants

herein sought to arbitrate certain disputes alleged to exist between appellants and The White House.

On January 27, 1965, the day after said letter had been sent to The White House and before receiving any response thereto, appellants filed in the Superior Court for the State of California, in and for the City and County of San Francisco, their "Petition For Order Directing That Arbitration Proceed And Complaint For Injunctive Relief Pending Arbitration Award." (R. 4-11.) No attempt was made by appellants prior to the filing of said petition to comply with the provisions of Section 33 of the Collective Bargaining Agreement between appellants and The White House (R. 7-8), providing for reference of the disputes to an adjustment board before resort to arbitration.

Upon the filing of the petition on January 27, 1965, an ex parte temporary restraining order was entered by the Superior Court, restraining and enjoining The White House from dissipating its assets below the level of $158,000.00, and an order to show cause was entered thereon with a return date of February 9, 1965.

On February 3, 1965, The White House filed a voluntary petition in bankruptcy in the United States District Court for the Northern District of California, Southern Division, and subsequently was duly adjudicated a bankrupt. On the same date, C. E. Strobel was appointed as receiver for the bankrupt.

On February 8, 1965, the United States District Court having jurisdiction over the bankruptcy pro-

ceedings entered its order enjoining the further prosecution of suits against the bankrupt. (R. 47-48.)

On February 9, 1965, the return date set in the order to show cause entered by the Superior Court on January 27, 1965, a hearing was held before the Honorable Joseph Karesh, Judge of said Superior Court. There were present at said hearing Roland C. Davis, Esq., representing appellants, and George O. Bahrs, Esq., representing The White House. During the course of said hearing, the full text of the order which had been entered by the United States District Court on February 8 restraining further action against the bankrupt was read into the record. (Reporter's transcript of hearings before the Superior Court, pages 4-5.)[1] After said order had been read into the record and despite the clear terms thereof, counsel for appellants proceeded to prosecute appellants' application for an order requiring arbitration and for a preliminary injunction.

A continued hearing on the matter was held on February 10, 1965, at which said hearing the attorney for the receiver made a special appearance to object to the jurisdiction of the Court. (R.T. 22.) Ultimately on February 11, 1965, the Court entered an order directing arbitration and granting a preliminary injunction requiring the deposit in Court of the sum of $158,000.00, pending the arbitration award or further

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[1]The reporter's transcript of the hearings held in the Superior Court on February 9, 10 and 11, 1965, has been made a part of the Record on Appeal by stipulation between appellants and these appellees. Said transcript will hereinafter for convenience be referred to as "R.T."

order of the Court. The Court never considered the scope of the arbitration proceedings.

Appellees, the trustees in bankruptcy of The White House, were not elected until February 24, 1965, and were neither parties to nor participated in any way in the state court proceedings above referred to.

On February 11, 1965, attorneys for The White House filed in the United States District Court for the Northern District of California, Southern Division, a petition for removal (R. 3) to that court of the state court action under the provisions of Section 1441 of the Judicial Code. (28 U.S.C. §1441.) The petition alleged that The White House was engaged in interstate commerce and that the matter was, therefore, within the original jurisdiction of the United States District Court pursuant to the provisions of Section 301(a) of the Labor Management Relations Act, as amended. (29 U.S.C. §185(a).)

On February 17, 1965, appellants filed a motion to remand pursuant to the provisions of 28 U.S.C. §1447(c). Said motion was denied on March 3, 1965.

Thereafter on March 16, 1965, a hearing was held on appellees' motion to dissolve the orders of the Superior Court, the trustees in bankruptcy of The White House having intervened in the action by stipulation of the parties and after leave to intervene had been granted by the Referee in Bankruptcy having jurisdiction over the matter. On said date, appellees' motion was granted by the District Court and its order issued on March 23, 1965, dissolving all said state court orders.

Appellants on April 21, 1965, filed in this court a notice of appeal under 28 U.S.C. §1291 appealing from the orders of the United States District Court entered on March 23, 1965, dissolving the order compelling arbitration and preliminary injunction entered by the Superior Court of the State of California. No appeal was taken from the order denying the motion to remand entered by the United States District Court on March 3, 1965, and appellees, therefore contend that the denial of the motion to remand is not properly before this court. See *Gannon v. American Airlines,* 251 F.2d 476, 482 (10th Cir. 1958).

QUESTIONS INVOLVED

1. Whether the Court of Bankruptcy pursuant to jurisdiction granted it by Section 2 of the Bankruptcy Act (11 U.S.C. §11) is the proper forum for the determination of controversies concerning the assets of the bankrupt estate.

2. Whether the appellants made a proper showing for the granting of a preliminary injunction.

3. Whether the removal to a federal court of a suit arising under Section 301(a) of the Labor Management Relations Act (29 U.S.C. §185(a)) was proper.

SUMMARY OF ARGUMENT

The Bankruptcy Act, passed pursuant to constitutional authority specifically dealing with bankruptcy

(U.S. Const., Art. I, §8, cl. 8), gives the Bankruptcy Court exclusive jurisdiction to determine controversies involving the assets of the estate of a bankrupt, unless some specific federal statute clearly indicates that a particular type of controversy is to be adjudicated by some other tribunal.

Neither the National Labor Relations Act nor the Labor Management Relations Act contains any provisions which give arbitration pursuant to a collective bargaining agreement jurisdiction paramount to that afforded to the Bankruptcy Court by the provisions of Section 2 of the Bankruptcy Act.

Appellees argue that Section 2(1) of the Labor Management Relations Act (29 U.S.C. §152(1)), specifically refers to and includes trustees in bankruptcy and receivers as persons subject to the coverage of the law. The definition contained in Section 2(1) does not relate to proceedings under Section 301(a) of the Labor Management Relations Act (29 U.S.C. §185(c)) and merely relates to proceedings before the National Labor Relations Board.

Although appellants state that the arbitration process is accorded a "preferred status" by "National Labor Policy," appellants are unable to cite a single case where arbitration was ordered after the employer had been adjudicated a bankrupt under the provisions of the Bankruptcy Act. The cases cited by appellants for the proposition that the National Labor Relations Act takes precedence over the Bankruptcy Act all involved proceedings before the National Labor Relations Board, a tribunal given primary jurisdiction for

the resolution of certain labor disputes. See National Labor Relations Act §10 (29 U.S.C. §160).

Equality of distribution of available assets to creditors is the keystone of national bankruptcy policy as evidenced by the Bankruptcy Act and in order to effectuate said policy, Congress has given the Bankruptcy Court exclusive jurisdiction to determine controversies involving the estate of a bankrupt. Appellants have failed to show any reason why the judicial remedies available to them, i.e. the filing of a claim in the bankruptcy proceedings and/or the filing of a petition in reclamation, will not give them adequate relief. This case does not involve any broad question involving national labor policy, the only issues being the liability of the bankrupt estate for the payment of alleged pensions due to former employees of The White House. Monetary disputes of this type are handled by the Bankruptcy Court on a day-to-day basis in the normal course of the administration of any bankrupt estate.

Appellants sought below the extraordinary remedy of an injunction whereby certain assets presently in the custody of the Bankruptcy Court would be carved out of the estate pending an arbitration award. Such injunction should not be awarded unless it is clear that appellants are entitled to prevail on the merits of their claim and unless irreparable injury will result if an injunction be denied. As stated above, appellants have the remedy of filing a petition in reclamation in the Bankruptcy Court to determine the merits of their so-called trust claim and as long as

said remedy is available, the remedy of injunction is inappropriate. Also it is clear on the merits that appellants are unsecured creditors of the bankrupt estate and are not entitled to any priority over the other unsecured creditors. See *McKey v. Paradise,* 299 U.S. 119 (1936); *Schuyler v. Littlefield,* 232 U.S. 707 (1914).

The United States Supreme Court in *Textile Workers Union v. Lincoln Mills,* 353 U.S. 448 (1957) held that Section 301 of the Labor Management Relations Act (29 U.S.C. § 185) created a substantive federal right. In *Teamsters Union v. Lucas Flour Co.,* 369 U.S. 95 (1962), the Supreme Court further amplified its position with respect to Section 301 by holding that said section preempted the field and that although suits to enforce Section 301 could be brought in the state courts under their concurrent jurisdiction (see *Dowd Box v. Courtney,* 368 U.S. 502 (1962)) that nevertheless in such action federal substantive law must be applied. It is quite clear from the above cited cases that an action under Section 301 "arises under" the laws of the United States and is removable under 28 U.S.C. § 1441. In certain areas where Congress did not intend an action to be removable, although arising under the laws or the Constitution of the United States, Congress has expressly so provided, and in the absence of such a provision, the general removable statute applies, allowing a defendant in a state court action to remove an action arising under the laws of the United States to the federal courts. That is clearly the situation in this case.

ARGUMENT

I.

ONCE A PETITION IN BANKRUPTCY HAS BEEN FILED, THE BANKRUPTCY COURT HAS EXCLUSIVE JURISDICTION OVER ALL PROPERTY OF THE BANKRUPT IN ITS ACTUAL OR CONSTRUCTIVE POSSESSION.

A. The exclusive jurisdiction of the Bankruptcy Court extends to a determination of all claims against the bankrupt estate and to the determination of title to property.

Section 2a(7) of the Bankruptcy Act gives the Bankruptcy Court jurisdiction to:

> "(7) Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto . . ." (11 U.S.C. Section 11a(7).)

Section 2a(2) of the Bankruptcy Act gives the Court power to:

> "Allow claims, to disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates;" (11 U.S.C. Section 11a(2).)

The purpose of the above cited sections, as well as other sections of the Bankruptcy Act, is to provide for the efficient, economical administration of the estates of bankrupts to the end that the maximum amount will be available for distribution to the creditors of the bankrupt and other parties entitled thereto. If the determination of claims were allowed to be adjudicated by other tribunals, the resulting delay and expense to the estate would be considerable.

If appellants do in fact have a claim against the estate of the bankrupt, it is as yet unliquidated and

cannot be allowed until filed with the Referee in Bankruptcy and the amount thereof ascertained. How and in what manner such ascertainment is had is a proper matter for the Bankruptcy Court to determine. Section 57d of the Bankruptcy Act (11 U.S.C. § 93d) provides:

> "Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by parties in interest or unless their consideration be continued for cause by the court upon its own motion: *Provided, however,* that an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administration of the estate or any proceeding under this Act."

Even assuming that appellants herein have a valid trust claim, nevertheless, the proper court to determine such dispute is the Court of Bankruptcy, and the exclusive remedy of a trust claimant is to file a petition in reclamation. So long as the property involved was in the actual or constructive possession of the Bankruptcy Court at the time of the filing of the petition in bankruptcy, the Bankruptcy Court is the proper tribunal for the determination of questions of title. *Thompson v. Magnolia Petroleum Co.,* 309 U.S. 478 (1940); *Ex Parte Baldwin,* 291 U.S. 610 (1933). As the Court said in the *Baldwin* case:

> "All property in the possession of the bankrupt of which he claims the ownership passes upon the filing of a petition into the custody of the Court of Bankruptcy. To protect its jurisdiction from interference, that Court may issue an injunction. . . . But the exclusive jurisdiction acquired by the Bankruptcy Court . . . was not limited to the prevention of interference with the use of the land . . . the jurisdiction extends also to the adjudication of the questions respecting the title." (291 U.S. at 615-616).

B. The Bankruptcy Court will not lightly abdicate its exclusive jurisdiction and will not do so unless there are supervening federal statutes or difficult problems of state law which can best be resolved by a state court tribunal, or unless some other irreparable injury can be shown by a claimant.

Although the Bankruptcy Court in the exercise of its judicial discretion may surrender its jurisdiction to another tribunal, such surrender will not occur except in unusual and exceptional circumstances. *Mangus v. Miller,* 317 U.S. 178 (1942). Appellants in this action have failed to show any compelling reasons why the Bankruptcy Court in this matter should surrender its exclusive jurisdiction.

The cases cited by appellants in their brief illustrate the above principles. Thus, they either involve supervening federal legislation, e.g., *Anderson v. Bigelow,* 130 F.2d 460 (9th Cir.), *cert. denied,* 317 U.S. 690 (1942) (involved Norris-LaGuardia Act which provides that *no* court of the United States may issue an injunction involving a labor dispute); *In re Spier Aircraft Corp.,* 137 F.2d 736 (3rd Cir. 1943), *cert.*

denied, 321 U.S. 770 (1944) (involved priority of navy wartime regulations over the Bankruptcy Act); *Cullen v. Bowles,* 148 F.2d 621 (2nd Cir. 1945) (explicit provisions of the Emergency Price Control Act vested exclusive jurisdiction in the Emergency Court of Appeals); *Order of Railway Conductors v. Pitney,* 326 U.S. 561 (1946) (involved a dispute expressly within the jurisdiction of an adjustment board created by statute to act in the case of jurisdictional disputes between unions), or difficult questions of state law and the Bankruptcy Court in the exercise of its judicial discretion held that the matters were more properly determined in state court tribunals. E.g., *Thompson v. Magnolia Petroleum Co.,* 309 U.S. 478 (1940) (involved unresolved state property law); *Milens v. Bostian,* 139 F.2d 282 (8th Cir. 1943) (involved effect of renunciation of one-quarter interest in the property of an interstate by an heir); *Layton v. Thayne,* 144 F.2d 94 (10th Cir.), *cert. denied,* 313 U.S. 572 (1944) (involved questions involving right of redemption).

The case of *Foust v. Munson S.S. Lines,* 299 U.S. 77 (1936), illustrates another limited area where the Court, in its judicial discretion, will abdicate its exclusive jurisdiction. In the *Foust* case, a federal court proceeding had been commenced with respect to a personal injury claim and the trustee in bankruptcy sought an injunction staying the proceeding. The Supreme Court held that the plaintiff would be irreparably injured by such a stay since a determination of the claim by the Bankruptcy Court might not allow the

plaintiff to proceed under a state direct action statute against an insurer who had insured the bankrupt's tort liability. The Court also found that allowing the federal court proceeding to continue could result in no prejudice to the bankrupt estate and in weighing the equities determined that the federal court proceedings should continue.

C. Neither the National Labor Relations Act, the Labor Management Relations Act nor "Federal Labor Policy" requires the Bankruptcy Court to abdicate its exclusive jurisdiction in favor of arbitration under the facts of this case.

Appellants rely heavily on the contention that Section 2(1) of the Labor Management Relations Act, as amended (29 U.S.C. § 152(1)), makes trustees in bankruptcy persons who are "covered by the Act" and that, therefore, trustees in bankruptcy are employers within the meaning of Section 301 of the Labor Management Relations Act (29 U.S.C. Section 185a).

Section 152(1) reads as follows:

> "Section 152. Definitions.
>
> When used in this *subchapter*—
>
> (1) the term 'person' includes one or more individuals, labor oragnizations, partnerships, associations, corporations, legal representatives, trustees, trustees in bankruptcy, or receivers." (Emphasis added.)

It should be noted that the above definition only applies to the particular subchapter in which Section 2(1) appears. Section 2(1) appears in subchapter II of chapter 7 of U.S. Code Title 29 whereas Section 301(a) appears in subchapter IV of chapter 7 of

Title 29. It is, therefore, apparent that the definition contained in Section 2(1) has no applicability to the meaning of terms as used in Section 301. The reference to "trustee in bankruptcy" is with respect to the definition of the word "person" and said word does not appear in Section 301. The word "person" does appear in the sections dealing with unfair labor practices (29 U.S.C. § 158), and with the jurisdiction of the National Labor Relations Board (29 U.S.C. § 160). Both Section 158 and Section 160 are part of subchapter II of chapter 7 to which the definition of "person" in Section 2(1) applies.

Section 301(a) deals with suits involving disputes between labor unions and "employers", and the definition of "employer" in Section 2 does not refer to trustees in bankruptcy. From the foregoing, it appears clear that a trustee in bankruptcy is subject to the jurisdiction of the National Labor Relations Board, but that nothing in the statute makes a trustee in bankruptcy subject to suit pursuant to Section 301.

The reasons for making a trustee in bankruptcy subject to the provisions of Sections 158 and 160 of the National Labor Relations Act, as amended by the Labor Management Relations Act, is made clear in *Nathanson, Trustee v. NLRB,* 344 U.S. 25 (1952), where the court said:

> "and where the matter in controversy had been entrusted by Congress to an administrative agency, the Bankruptcy Court normally should stay its hand pending an administrative decision. . . . It is the Board, not the Referee in Bankruptcy, nor the Court, that has been en-

> trusted by Congress with authority to determine what measures will remedy the unfair labor practices." (344 U.S. at 30.)

Thus, Congress has set up a specific agency for the determination of specific types of disputes, and the Bankruptcy Courts have properly accommodated themselves to this expression of Congressional intent. The situation with respect to arbitration, however, is exactly to the contrary since arbitration is not a creation of federal statute, but rather is the creature of a contract between private parties. *United Steel Workers v. Warrior & Gulf Nav. Co.,* 363 U.S. 574 at 582-583 (1960); *Retail Clerks Local 770 v. Thriftimart, Inc.,* 59 C.2d 421, 380 P.2d 385 (1963).

NLRB v. Coal Creek Co., 204 F.2d 579 (10th Cir. 1953); *NLRB v. Baldwin Locomotive Works,* 128 F.2d 39 (3rd Cir. 1942); and *Matter of American Buslines,* 151 F.Supp. 877 (D.C. Neb. 1957), cited by appellants, all involved proceedings before the National Labor Relations Board and do not involve arbitration proceedings pursuant to Section 301 of the Labor Management Relations Act.

Appellants also cite Section 15 of the Labor Management Relations Act (29 U.S.C. § 165) as authority for their contention that the arbitration provisions of the contract supersede the provisions of the Bankruptcy Act. Said section provides as follows:

> "Section 165. Conflict of laws.
>
> Whenever the application of the provisions of Section 672 of Title 11 conflicts with the application of the provisions of this subchapter, this

> subchapter shall prevail: *Provided,* that in any situation where the provisions of this subchapter cannot be validly enforced, the provisions of such other Acts shall remain in full force and effect."

Section 672 of Title 11 refers to the corporate reorganization provisions of the Federal Bankruptcy Act and has no applicability whatsoever to so-called straight bankruptcy. In this regard, Section 101 of Chapter X (11 U.S.C. § 501) provides that "the provisions of this chapter shall apply exclusively to proceedings under this chapter." In the case of *In the Matter of Klaber Bros.,* 173 F.Supp. 83 (S.D. N.Y. 1959), the court held that Section 15 did not apply to a debtor proceeding under Chapter XI of the Bankruptcy Act.

A distinction between Chapter X and other proceedings under the Bankruptcy Act is readily understandable when one reviews the purpose and intent of Chapter X. Chapter X looks to the reorganization of a debtor corporation with the emergence of the same from the Chapter X proceedings as a going concern. Furthermore, such proceedings frequently take many years during which time an active business is being conducted by the debtor. In straight bankruptcy proceedings there is a discontinuance of the business of the debtor and in effect its "corporate death."

Appellants' premise that the federal labor policy seeks to promote industrial stabilization through the collective bargaining agreement contains within itself the key to its limitation and the numerous cases cited

in support of said proposition do embrace this principle as between employees and an *existing bargaining unit.* When the latter ceases to exist the reason for enforcement of collective bargaining agreements also ceases to exist. All of the cases cited by appellants on pages 17 and 18 and the top of page 19 of their brief are devoted to circumstances involving disputes between employees and an existing employer.

The distinction between the existing business line of cases cited by appellants and a case where the employer has ceased to be in business is well expressed in *In the Matter of Muskegon Motors Specialties Co.,* 313 F.2d 841 (6th Cir.), *cert. denied,* 375 U.S. 832 (1963), where the Court stated:

> "In the case at bar, as the District Court found, labor peace was not an issue. The employer was out of business and had no plant or employees. The collective bargaining agreement had expired on April 14, 1961. Whatever rights the employees had for vacation pay under the collective bargaining agreement had already become fixed. All that remained was a question of law which, it seems to us, could be better passed upon by the court rather than an arbitrator. This case does not involve working conditions or practices in a shop, but the law of the land.
>
> "The cases where the Bankruptcy Court surrendered jurisdiction do not support the Union's position. In those cases, jurisdiction was surrendered either to another court of competent jurisdiction or to an administrative agency which was empowered by law to hear and determine the particular controversy." (313 F.2d at 843.)

Appellants attempt to deal with the *Muskegon* case by stating that the same is erroneous in light of *Republic Steel v. Maddox,* 379 U.S. 650 (1965). It is clear that the *Maddox* case in no way overruled or makes inapplicable the *Muskegon* case or the reasoning of the Court therein contained and cited above.

In *Maddox,* the Court in dicta stated that the arbitration provisions of a collective bargaining agreement must be followed even when there has been a permanent plant shutdown. This dicta, however, is not addressed to the situation where the employer no longer exists as is true in this case since the adjudication of The White House as a bankrupt. The Court explains its reasoning as follows:

> "If applicable law permitted a court suit for severance pay in any circumstances without prior recourse to available contract remedies, an employer seeking to limit the modes of redress that could be used against him could do so only by eliminating contract grievance procedures for severance pay claims." (379 U.S. at 656.)

If this Court holds in this case that appellants' claims are to be determined by the Bankruptcy Court, no multiplicity of remedies as is envisaged by the Supreme Court could arise since the sole remedy would be the one stated by the Bankruptcy Act, i.e., determination of claims against the estate by the Bankruptcy Court. Furthermore, upon his adjudication as a bankrupt, the employer no longer has any interest in the outcome of the union's claim. Thus, at the contract negotiation stage, the employer would not be

concerned about the remedies available to the union in the event of the corporation's ultimate bankruptcy.

The Court goes on in *Maddox* to state that there are no positive reasons why the general federal rule in favor of arbitration should not apply. As is stated above, the whole purpose of the jurisdiction conferred upon the Bankruptcy Court by Section 2 of the Bankruptcy Act is to provide a single forum for the determination of claims against the bankrupt estate in order to achieve an expeditious, efficient, and inexpensive administration of the bankruptcy estate. In the instant case complicated issues on the merits exist and the expense to the bankrupt estate of arbitration proceedings could and most likely would be considerable. The collective bargaining agreements also provide for a preliminary hearing before an adjustment board and then a resort to arbitration. This lengthy procedure could unduly delay the administration of the bankrupt estate. Furthermore, once a petition in bankruptcy has been filed, the rights of creditors are involved. The creditors of the bankrupt would have a right to participate in any hearings on the claim of the union held before the Bankruptcy Court (see Bankruptcy Act § 57, 11 U.S.C. § 93) whereas they would not be parties to an arbitration.

Of all the numerous cases cited by appellants in their brief, they do not cite, nor is there any reported instance where the arbitration provisions of a collective bargaining agreement have been held enforceable against a contracting employer undergoing

liquidation in a straight bankruptcy proceeding or against the trustee of such bankrupt estate. The only case on point is *In Re Muskegon Motor Specialties Co.,* supra.

It is submitted based upon the foregoing that the District Court was correct in determining that nothing in the National Federal Labor Policy or in national statutes requires the Bankruptcy Court to surrender its exclusive jurisdiction over the property of the debtor in favor of contractual provisions for arbitration. The appellants have shown no compelling reason why the normal rule in favor of the exclusive jurisdiction of the Bankruptcy Court should not apply in this case.[2]

Under Section 57d of the Bankruptcy Act (11 U.S.C. § 93d), the manner of liquidation of unliquidated claims is left to the discretion of the Bank-

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[2]Appellants cite the cases of *Tobin v. Plein,* 301 F.2d 378 (2nd Cir. 1962),, and *Schilling v. Canadian Foreign S.S. Co.,* 190 F.Supp. 462 (S.D.N.Y. 1961) for the proposition that the trustee in bankruptcy may be compelled to submit a dispute to arbitration pursuant to the terms of a collective bargaining agreement. Neither of said cases stands for such a proposition. In *Tobin v. Plein,* supra, the trustee sought arbitration of a claim *in favor* of the bankrupt estate and the Court held merely that the provisions of Section 26 of the Bankruptcy Act (11 U.S.C. Section 49) did not supersede any contractual arrangements with respect to arbitration which may have existed. In the *Schilling* case, supra, the Court held that a trustee suing on a claim *in favor* of the bankrupt estate must abide by an arbitration provision in the contract upon which the trustee was suing. In neither instance would the Court have had summary jurisdiction pursuant to Section 2 of the Bankruptcy Act and said cases are completely inapposite to the proposition for which they are cited. In fact appellants correctly admit that the Court in *Schilling* implies that the rule would be otherwise where the party seeking arbitration is a creditor of the bankrupt.

ruptcy Court. It is within the power of the Referee in Bankruptcy to order liquidation of a claim by reference to arbitration and this is a matter which should be left to the sound discretion of the Referee. In 3 *Collier on Bankruptcy,* 243 (14th Ed. 1964), it is noted that arbitration is one of the means of liquidation of an unliquidated claim, but:

> "The Court, however, will ordinarily be inclined to reserve to itself some degree of control, be it by appointing the expert a special master or by otherwise securing to itself and the parties the power to treat the expert's estimate as a mere aid to the Court, the final word being with the latter."

Unlike the reviewability of arbitration initiated by the Bankruptcy Court as is contemplated by *Collier* above, the reviewability of a decision by a labor arbitrator is extremely limited. See *United Steel Workers v. Warrior & Gulf Nav. Co.,* 363 U.S. 574 (1960).

In their request for arbitration, appellants seek not only to arbitrate the question of the amount of pensions due, and whether The White House breached the collective bargaining agreement, but also seek to arbitrate whether or not a trust existed and if so, whether or not the Unions are entitled to receive the full amount of their claims in priority to the claims of other unsecured creditors. As stated above, any such determination by an arbitrator would be reviewable only to an extremely limited extent. Thus, the relief sought in this case by arbitration by appellants is greater than the relief granted to the National Labor Relations Board by the Supreme Court in *Nathanson, Trustee v. NLRB,* 344 U.S. 25 (1952).

Even if this Court believes that under the facts of this case appellants are entitled to a *limited* arbitration, it would seem clear that the question of the priority of the claims of appellants is a matter to be determined by the Bankruptcy Court. See *Nathanson, Trustee v. NLRB,* supra, and *NLRB v. Deena Artware,* 207 F.2d 798 (6th Cir. 1953).

II

EVEN ASSUMING THAT SOME PORTION OF THE DISPUTES BETWEEN THE TRUSTEES AND THE UNIONS SHOULD BE SUBMITTED TO ARBITRATION, NO SHOWING HAS BEEN MADE TO SUSTAIN THE INJUNCTION GRANTED IN THE STATE COURT PENDING SUCH ARBITRATION.

The order entered by Judge Karesh in the state court proceeding was entered after The White House filed its petition in bankruptcy and after its adjudication as a bankrupt and therefore, after all of its property came into the custody of the Bankruptcy Court. The order was entered prior to the appointment of the trustees in bankruptcy and at a hearing where the receiver did not appear. (R.T. 21, 22, 43-46.) No attempt was made by appellants to obtain leave from the Bankruptcy Court to sue the receiver as is required by law. *Chicago R. I. & R. Ry. Co. v. City of Owatonna,* 120 F.2d 266 (8th Cir. 1941). The order was in fact entered at a time when there was in force an order issued by the Honorable Alfonso J. Zirpoli, Judge of the United States District Court, enjoining the further prosecution of suits against the bankrupt. (R. 47-48.) It is submitted that under the above circumstances

appellants should not be allowed to remove the sum of $158,000.00 from the custody of the Bankruptcy Court as required by the state court order.

Even absent the above circumstances, in order for the Court to grant an injunction under both the laws of the State of California and the Federal Rules of Civil Procedure, it is necessary for appellants to show that they would suffer irreparable injury were an injunction denied and that they have no other adequate remedy at law. *Foundry Services, Inc. v. Beneflux Corp.,* 206 F.2d 214 (2d Cir. 1953); *City & County of San Francisco v. Market St. Ry. Co.,* 95 Cal.App.2d 648, 213 P.2d 780 (1950). Appellants are unable to make such a showing since they could protect their position by filing a contingent claim in the bankruptcy proceedings while reserving their right to have the matter adjudicated by arbitration. See *In Re Dato,* 99 F.2d 703 (7th Cir. 1938). Since the estate could not be distributed until such time as appellants' contingent claim had been determined, no injury could result to appellants by the denial of the injunction.

The granting of the injunction does injury to the estate and to the other creditors interested therein. The trustees are required to deposit all funds of the estate in a bank account and are now authorized to place the same in a savings account, thus earning interest for the creditors while the estate is pending. Bankruptcy Act § 47a(2) (11 U.S.C. § 75a(2).) If the injunction is granted this interest would be lost to the estate.

It is also quite clear that appellants' claim, insofar as they seek to establish a trust claim having a priority over the claims of other unsecured creditors of The White House, is ill-founded and that the request for an injunction should be denied.

It is important preliminarily to note the factual basis upon which appellants' trust claim is made. In 1958, The White House as a member of the San Francisco Retailers Counsel, entered into a collective bargaining agreement with Department Store Employees Union Local No. 1100 RCIA. (Exhibit "A" of plaintiff's complaint in Superior Court.)[2a] Said agreement provided in part that either party to the agreement could reopen the same on June 1, 1959, or June 1, 1960 with respect to pensions. Pursuant to the terms of said agreement, the agreement was reopened with respect to pensions and on September 16, 1959, an agreement was reached with the Union whereby The White House agreed to set up certain pension benefits for its employees. Exhibit "B", pages 3-6.) The agreement provided that said pensions were to be funded but did not spell out the methods for funding the same In accordance with the provisions of the said agreement of September 16, 1959, The White House subsequently entered into an agreement of trust with th Bank of America National Trust and Savings Association wherein The White House was the trustor an said bank was the trustee. (R. 95-111.) Pursuant t

[2a]Exhibits A, B, C, D and E of plaintiff's complaint in the Su perior Court have been made a part of the Record on Appeal b stipulation between appellants and these appellees. Said exhibi will hereafter for convenience be referred to as "A", "B", et

the terms of said trust agreement, The White House agreed to make certain contributions to the trust to live up to its agreement under the terms of the collective bargaining agreement. In fact, contributions to said trust were made in the amount of $1,115.89 (Aff. of Walter Johnson, R. 91), and as to such sum, the trustees herein would concede that appellants have a valid trust claim.

The above facts are strikingly similar to those before the Court in the case of *McKey v. Paradise,* 299 U.S. 119 (1936). In that case, the bankrupt employer withheld certain amounts from the wages of employees which were to be paid over by the employer to a welfare association which provided health and other welfare benefits to the employees. The Supreme Court held that the breach of such an agreement did not give the employees any equitable title or lien upon any part of the bankrupt's property, stating:

> "It would be impossible to state all the circumstances in which equity will fasten a constructive trust upon property in order to frustrate a violation of fiduciary duty. See 3 Pom. Ed. Jur. Sections 1044 et seq. But the mere failure to pay a debt does not belong in that category. We do not find that the record shows anything more than that in this instance. (Citing cases.) The fact that the failure to pay the association was an acute disappointment and was especially regrettable as the claimant was an association of employees cannot avail to change the debtor to a trustee or enable the creditor to obtain a preference over other claims against a bankrupt estate." (299 U.S. at 122-123.)

> proceedings. §64(a)(2). We would depart from that policy if we granted the priority to one class of wage claimants irrespective of the amount of the claim or the time of its accrual. The theme of the Bankruptcy Act is 'equality of distribution' *(Sampsell v. Imperial Paper & Color Corp.,* 313 U.S. 215, 219, 85 L.Ed. 1293, 1298, 61 S.Ct. 904); and if one claimant is to be preferred over others, the purpose should be clear from the statute. We can find in the Bankruptcy Act no warrant for giving these back pay awards any different treatment than other wage claims enjoyed." (344 U.S. at 28-29.)

Similarly, in *United States v. Embassy Restaurant,* 359 U.S. 29 (1959), the court denied priority under factual circumstances quite similar to those now before the court. In that case, the bankrupt employer had been bound by the terms of a collective bargaining agreement to contribute to a welfare fund for the benefit of employees. The court refused to grant any priority status to such contributions.

Appellants' position that they are entitled to a priority position although they are unable to establish that a trust existed, or that there is any particular *res* or fund which they can identify is contrary to every precept of the bankruptcy law and the relief sought cannot properly be granted without doing violence to the provisions of the Bankruptcy Act and working irreparable prejudice to all of the other creditors who are entitled to look to that Act for their protection.

It was this precise concern which moved the court to deny the type of injunctive relief sought here in

NLRB v. Deena Artware, 207 F.2d 798 (6th Cir. 1953). There, as here, the amount due to employees was unliquidated but was estimated to be $100,000.00. As in the present case, the petitioners there sought an order restraining the employer from transferring assets on the ground that it was deliberately depleting its assets to avoid payment of any award which might be made for back pay. In refusing to issue such an order, the court stated that not only had no actual damage as yet been established, but even after establishment, such claims would have no priority over other creditors in the event of insolvency.

III.

THE COURT BELOW PROPERLY DENIED APPELLANTS' MOTION TO REMAND.

A. A suit to compel arbitration pursuant to the terms of a collective bargaining agreement between an employer and a labor organization representing employees in an industry affecting commerce is one founded on a claim or right arising under the constitution, treaty, or laws of the United States so as to make it removable within the meaning of Section 1441 (b) of Title 28 of the Judicial Code (The Removal Statute).

Congress in 1947 adopted Sections 301(a) and (b) of the Labor Management Relations Act (29 U.S.C. §§185(a) and (b)) which provide as follows:

> "(a) Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this chapter, or between any such labor organizations, may be brought in any district

> court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.
>
> "(b) Any labor organization which represents employees in an industry affecting commerce as defined in this chapter and any employer whose activities affect commerce as defined in this chapter shall be bound by the acts of its agents. Any such labor organization may sue or be sued as an entity and in behalf of the employees whom it represents in the courts of the United States. Any money judgment against a labor organization in a district court of the United States shall be enforceable only against the organization as an entity and against its assets, and shall not be enforceable against any individual member of his assets."

A majority of the Supreme Court in *Textile Workers Union v. Lincoln Mills,* 353 U.S. 448 (1957) held that Section 301 was not merely a jurisdictional statute, but was intended by Congress to allow the federal courts to fashion a sustantive body of federal labor law involving disputes between employers and unions who are parties to collective bargaining agreements. The doctrine of the majority in the *Lincoln Mills* case was further elucidated by the Court in *Teamster's Union v. Lucas Flower Co.,* 369 U.S. 95 (1962), wherein the Court held that although the state courts have concurrent jurisdiction with the federal courts in suits arising under Section 301, that nevertheless federal substantive law must be applied in such cases.

It is clear from *Lincoln Mills, Lucas Flower* and *Dowd Box v. Courtney,* 368 U.S. 502 (1962), that actions under Section 301 are actions arising under the laws of the United States, that both the federal and the state courts have concurrent jurisdiction with respect thereto and that in an action arising under Section 301 federal substantive law must be applied. The situation is thus similar to numerous federal statutes creating substantive rights where Congress has provided the federal and state courts with concurrent jurisdiction, but where a defendant in such an action is given the right by Section 1441 to remove the same to the federal courts. This interpretation of Section 301 is the one universally followed by the federal courts. See, *e.g., Old Dutch Farms Inc. v. Milk Drivers & Dairy Employees Union Local 584,* 222 F. Supp. 125 (E.D.N.Y. 1963); *Central Metal Products v. International Union,* 195 F. Supp. 70 (E.D. Ark. 1961); *Swift & Co. v. United Packing House Workers,* 177 F. Supp. 511 (D.C. Colo. 1959); *Minkoff v. Grant & Frocks,* 172 F. Supp. 870 (S.D. N.Y. 1959); *Fay v. American Cystoscope Makers,* 98 F. Supp. 278 (S.D.N.Y. 1951).[3] In certain instances wherein both the federal and the state courts are given concurrent jurisdiction, Congress has expressly denied removal. See, *e.g.,* Federal Employers' Liability Act (28 U.S.C. §1445(a)); Securities Act of 1933 (15

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[3]The majority opinion in *American Dredging Co. v. Local 25, Marine Div., Int. U. of Op. Eng.,* 338 F.2d 837 (3rd Cir. 1964), *cert. denied,* 380 U.S. 935 (1965), is not to the contrary since the court held that the District Court was deprived of jurisdiction by Section 4 of the Norris-LaGuardia Act (29 U.S.C. §104).

U.S.C. §77v). There is no such provision with respect to Section 301(a).

Appellants contend that removal is prohibited by *Dowd Box,* supra. That case holds that Section 301 does not invest the federal courts with exclusive jurisdiction but merely grants jurisdiction which is concurrent with that of the state courts. Appellants argue that removal is not permitted where such concurrent jurisdiction exists, but that removal would only be permissible where exclusive jurisdiction is in the federal court. This is contrary to current law which holds that removal jurisdiction is "derivative jurisdiction" and can only be exercised if the state court has original concurrent jurisdiction. There can be no "derivative jurisdiction" where the federal courts have exclusive original jurisdiction. *Lambert Run Coal Co. v. Baltimore & Ohio R. Co.,* 258 U.S. 377 (1922).

Appellants contend that the memorandum of points and authorities filed by them in the state court shows that the action was one commenced under state law, to-wit: Section 1280 of the California Code of Civil Procedure. A case commenced under the California Arbitration Act (California Code of Civil Procedure §§1280 et seq.) may nevertheless be a suit arising under Section 301(a). See *Retail Clerks' Local 770 v. Thriftimart,* 59 C.2d 421, 380 P.2d 652 (1963).

B. The Court can look to the petition for removal to determine the status of the parties.

It has been held that even where the petition for arbitration in a state court does not reveal that the action is one falling under Section 301(a) (in that the petition for arbitration does not reveal the necessary relationship to interstate commerce), the Courts may look to the petition for removal to ascertain the status of the parties as affecting interstate commerce. *Minkoff v. Grant & Frocks, Inc.,* supra; *Fay v. American Cystoscope Makers,* supra. See also *Davenport v. Proctor & Gamble Manufacturing Co.,* 241 F. 2d 511 (2d Cir. 1957) (may look to petition for removal to determine jurisdictional amount).

There is an exception to the general rule cited by appellants that the basis for removal must be shown on the face of the plaintiff's complaint (*Gully v. First National Bank in Meridian,* 299 U.S. 109 (1936); *Pan American Petroleum Corp. v. Superior Court of Delaware,* 366 U.S. 656 (1961)), where the missing allegation concerns the status of one of the parties to the action. *Winters v. Drake,* 102 Fed. 545 (C.C.N.D. Ohio 1900).

The Court in *Fay v. American Cystoscope Makers,* supra, at pages 280-281, elucidated this exception as follows:

> "The normal rule in removal proceedings prohibits the court from looking outside the complaint, to determine whether or not a suit arises under federal law. . . . (Citations) However, where federal jurisdiction hinges on the parties, or one of them, having a particular status, the

court may ascertain the existence of that status independently of the complaint. This latter rule has been applied to permit the court to ascertain the existence of diversity of citizenship, see, Chappell v. Waterworth, 1894, 155 U.S. 102, 107, 15 S. Ct. 34, 39 L.Ed. 85, and the federal nature of a receiver, Winters v. Drake, C.C., 1900, 102 F. 545, a corporation, Texas & Pacific Ry. C. v. Cody, 1897, 166 U.S. 606, 17 S.Ct. 703, 41 L.Ed. 1132, and a marshal, Wood v. Drake, C.C., 1895, 70 F. 881.

"The jurisdiction of the district court under 29 U.S.C.A. §185 depends upon one of the parties' holding a particular status, that is, a union representing employees in an industry affecting commerce. Where that status is asserted to exist, but is not mentioned in the complaint, the court is of the opinion that it may apply the status rule on removal and look beyond the complaint to ascertain the fact. To hold otherwise would vest the plaintiff with power to withhold from a defendant the use of that forum which Congress has chosen to make available.

"Such power in the plaintiff could only be justified if Section 185 left intact a separate and independent state cause of action for contract between unions and employers where the component of interstate commerce was present. . . . However, . . . it seems clear that Congress preempted the field in this area."

The above language was approved in IA *Moore's Federal Practice* §160 (2nd Ed. 1965.)

C. Removal was proper since the federal question involved was disclosed by voluntary statements made by appellants in the state court proceedings.

Section 1446(b) of Title 28 allows removal within twenty days after the filing of the plaintiff's complaint or within twenty days after the filing by the plaintiff of some other paper first disclosing the federal question involved. It has been held that such "other paper" can consist of oral testimony so long as the same is a part of the record of the proceedings in the state court. *Fuqua v. Gulf, Col. & Santa Fe Ry. Co.,* 206 F.Supp. 814 (E.D. Okla. 1962); *Bonnell v. Seaboard Airline R.R. Co.,* 202 F.Supp. 53 (N.D. Fla. 1962); *Gilardi v. Atchison, Topeka & Santa Fe Ry. Co.,* 189 F.Supp. 82 (N.D. Ill. 1960). Roland C. Davis, Esq., counsel for appellants, made it abundantly clear during the hearings conducted before Judge Karesh in the Superior Court that petitioner's claim for arbitration was one arising under the National Labor Relations Act. The following quotations from the reporter's transcript of the hearings held before Judge Karesh amply bear out this position:

> "Mr. Davis: In any event, I advised him (Referee Gillard) of our position that in view of the proceedings of the National Labor Relations Act, I had asked this Court to continue these proceedings so that I could file a memorandum to establish to this Court's satisfaction that the National Labor Relations Act provisions prevailed over the Bankruptcy Act, and that you could proceed . . ." (R.T. 6.)

> "Mr. Davis: Yes, Your Honor. As I explained it at the hearing yesterday, as to which this is a

continued hearing, in our view, Section 15 of the National Labor Relations Act is the basis for this Court's paramount jurisdiction over the Referee in Bankruptcy in a matter such as this, and this matter is a matter which arises under a collective bargaining contract between an employer of the Union which are subject to the terms of the National Labor Relations Act and Section 301 of that Act provides, and the United States Supreme Court has so held, that the Courts, both the state courts and the federal District courts, have jurisdiction to require the parties to a collective bargaining contract to arbitrate the controversy arising under that contract where the contract provides for arbitration as we say it does here." (R.T. 15.) (See also, R.T. 7.)

The above quoted voluntary statements made by counsel for appellants at the hearings before Judge Karesh adequately disclose the federal question involved and allowed removal to the federal district court under the provisions of Section 1446(b) of Title 28.

From the foregoing, it is evident that the removal was proper and that the order of the District Court denying the motion for remand should be sustained by this Court.

CONCLUSION

As has been above stated, upon the filing of a petition in bankruptcy and the adjudication of the debtor as a bankrupt, the Bankruptcy Court is vested with exclusive jurisdiction over all assets in the actual or constructive possession of the bankrupt. This jurisdiction is not lightly surrendered by the Bankruptcy Court. Appellants have been unable to show any law which would require the Bankruptcy Court to cede such jurisdiction, nor have they given any reasons why the Bankruptcy Court in the exercise of its judicial discretion should surrender such jurisdiction in favor of arbitration. Arbitration might delay the administration of the bankrupt estate and would result in unnecessary expense to the estate.

It is also clear that the appellants' claim, if any, is merely an unsecured claim against the bankrupt estate and that appellants have failed to show that they would be irreparably injured by the failure of this Court to sustain an injunction which has the effect of disposing of assets which are presently in the custody of the Bankruptcy Court. It is thus respectfully submitted that this Court affirm the order of March 23 entered by the United States District Court dissolving the orders entered in the state court.

Section 301 vests concurrent jurisdiction in the state and federal courts, and a defendant in an industry affecting interstate commerce has the right to remove an action under Section 301 commenced in the state courts to the federal courts under the provisions of 28 U.S.C. § 1441. The record of the proceed-

ings before Judge Karesh show that appellants were relying on the provisions of Section 301 and the uncontested allegations of the petition for removal show that appellee The White House was in an industry affecting interstate commerce. The denial of the motion for removal was thus proper.

Dated, San Francisco, California,
August 9, 1965.

Respectfully submitted,
DINKELSPIEL & DINKELSPIEL,
PILLSBURY, MADISON & SUTRO,
JAMES M. CONNERS,
By EDWARD R. STEEFEL,
Attorneys for Appellees John M. England, C. E. Strobel and Walter J. Hempy, as trustees in bankruptcy of Raphael Weill & Co., Inc., Bankrupt.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

EDWARD R. STEEFEL,
Attorney for Appellees John M. England, C. E. Strobel and Walter J. Hempy, as trustees in bankruptcy of Raphael Weill & Co., Inc., Bankrupt.

No. 20,087

IN THE

United States Court of Appeals

For the Ninth Circuit

Walter Johnson, individually and as Secretary-Treasurer of Department Store Employees Union, Local 1100, etc., et al.,
Appellants,

vs.

Raphael Weill & Company, Inc., d/b/a The White House, etc., et al.,
Appellees.

On Appeal from the United States District Court for the Northern District of California, Southern Division

BRIEF FOR APPELLANTS

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No. 20,087

IN THE

United States Court of Appeals
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WALTER JOHNSON, individually and as Secretary-Treasurer of DEPARTMENT STORE EMPLOYEES UNION, LOCAL 1100, etc., et al.,
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vs.

RAPHAEL WEILL & COMPANY, INC., d/b/a THE WHITE HOUSE, etc., et al.,
Appellees.

On Appeal from the United States District Court for the Northern District of California, Southern Division

BRIEF FOR APPELLANTS

JURISDICTION

Appellants commenced this action in the Superior Court of the State of California, in and for the City and County of San Francisco, and appellees obtained removal therefrom to the United States District Court for the Northern District of California, Southern Division, on the stated ground that the District Court had original jurisdiction under § 301 of the Labor Management Relations Act. (29 U.S.C. § 185.) The

District Court denied appellants' motion for remand to the state Court and then refused to direct arbitration of certain controversies between appellants and appellees pursuant to the terms of a collective bargaining agreement and refused to grant an injunction restraining and enjoining appellee from transferring, dissipating or otherwise disposing of certain funds which are the subject matter of the dispute sought to be arbitrated. Appellants, on April 21, 1965, filed in this Court a timely notice of appeal under 28 U.S.C. § 1291. This Court's jurisdiction accordingly rests upon 28 U.S.C. § 1291.

STATEMENT OF THE CASE

As the record herein shows (affidavit of Robert P. Cowell filed in support of Petition for Arbitration in California Superior Court Action No. 551474, R. 23-25), appellants learned for the first time on January 20, 1965, that respondent Raphael Weill & Company, d/b/a The White House (herein called the White House), had failed to provide a fund for the payment of pensions as required by the collective bargaining agreement between said respondent and the two labor organizations on behalf of which appellants bring this appeal.[1]

Although appellants were never specifically so advised by the White House the indications were that

[1]Said agreement and supplements thereto are part of the record herein as Exhibits A, B, and C to the aforesaid petition filed in the California Superior Court.

said respondent at this time had plans under way for the imminent closing of its business operations and the termination of its employees represented by the said Unions. Accordingly, the representatives of said Unions then and there demanded compliance with the funding requirements of the collective bargaining agreement as to pensions and observance of the agreement in certain other respects or, failing such compliance, arbitration under the agreement of said disputes. (Cowell affidavit, p. 2, R. 24.) Respondent White House failed either to comply as demanded or to proceed to arbitration.

Fearing dissipation of the White House assets before such compliance could be had, appellants made a hurried estimate of the amounts due to the pension fund (see affidavit of Walter Johnson, submitted to the District Court below, R. 90-94), and on January 27, 1965 filed their petition in said Superior Court for an Order Directing that Arbitration Proceed and Complaint for Injunctive Relief Pending Arbitration Award. The appellants instituted the action under the express provisions of state law, to wit, Section 1280, et seq., of the Code of Civil Procedure of the State of California. (See Memorandum of Points and Authorities, accompanying petition, R. 16-18.) On the same day, Presiding Judge Raymond Arata of the Superior Court issued a temporary restraining order enjoining and restraining appellees from disposing of, dissipating or otherwise transferring the assets of appellees to the extent of the approximate sum of $158,000.00, except for payment of wages, pending the

decision of the Court as to whether or not appellants were entitled to an arbitration award with respect to certain specified controversies, including the issue of funded pensions, arising from the terms of the collective bargaining agreement between appellants and appellees (R. 19-20).

Six days later, on February 3, 1965, the White House filed a voluntary petition in bankruptcy, No. 82953, in the United States District Court for the Northern District of California, Southern Division. On February 9, 1965, a hearing in the Superior Court was held on appellants' petition in the state Court action, and on the Order to Show Cause therein. The hearing was continued by the Court until February 11, 1965, with the attorney for the receiver of said appellee present. The Superior Court on February 11, 1965, granted the relief sought by appellants and directed arbitration of the controversies between the parties. The Court also on said date entered a preliminary injunction requiring the deposit in Court of the said \$158,000.00 pending the arbitration award or further order of the Court. (R. 49-51.) Said Order and Injunction was duly served on all parties.

Later on the same day, February 11, 1965, attorneys for appellees filed in the United States District Court for the Northern District of California, Southern Division, a petition for removal to that Court of the state Court action (R. 1-3). The ground asserted in support of the removal petition was that the state Court action is one in which the District Courts of the United States are given original jurisdiction by Sec-

tion 301(a) of the Labor Management Relations Act of 1947, as amended. (29 U.S.C. § 185(a).) (See Petition for Removal, p 3, R. 3.)

On February 15, 1965, the District Court issued an ex parte order requiring that the "Order Directing Arbitration to Proceed and for Preliminary Injunction" issued by the Superior Court of the State of California be stayed pending determination of appellees' motion to dissolve said order and to stay further proceedings (R. 55-56).

Appellants, on February 17, 1965, filed in the District Court a motion to remand pursuant to the provisions of 28 U.S.C. § 1447(c), and points and authorities in support thereof (R. 60-65, 81-84). In support of their motion to remand appellants set forth the well-established legal grounds that the party who brings suit is master to decide what law he will rely upon and that Section 301 of the Labor Management Relations Act, as amended (29 U.S.C., § 185) did not deprive state Courts of their traditional exercise of jurisdiction over suits for violation of collective bargaining agreements, citing *inter alia, Dowd Box v. Courtney,* 368 U.S. 502, 82 S. Ct. 519, 7 L. Ed. 2d 483.

Appellants' motion for remand was heard by the District Court on March 3, 1965, and denied on that day.

Thereafter appellants filed a memorandum of points and authorities in opposition to appellees' motion to dissolve the orders of the California Superior Court

(R. 71-79) and submitted an affidavit from Walter Johnson incorporating evidence not theretofore available to appellants (R. 90-94). This evidence consisted, in part, of (1) a trust agreement entered into in 1960 between the respondent White House and Bank of America National Trust and Savings Association purporting to establish a fund for the payment of the pension benefits to the employees represented by the said labor organization under their collective bargaining agreement with the White House (Exhibit A to Johnson affidavit); (2) the fact that only some $1100.00 had been contributed to said fund by the White House since the establishment of said fund; (3) the admission of the president of respondent White House, Ben R. Gordon, by a financial statement prepared in 1963 that at that time the White House had a contingent liability of approximately $300,000.00 in the form of *unfunded* pensions due these same employees (Exhibit B to Johnson affidavit); (4) that since the closing of the business of the White House upon its voluntary bankruptcy on February 3, 1965, there were some 53 former employees of the White House represented by the said Unions who had retired under said pension agreement, but who were no longer receiving pensions from the White House, although entitled thereto by the terms of said collective bargaining agreement, and that there were some 25 additional employees of the White House whose service entitled them to *funded* pensions under said collective bargaining agreement, but that said employees had received no such pension benefits

(R. 90-113). Appellees offered no denial or refutation of this evidence.

Thereafter, on March 16, 1965, a hearing in the District Court on appellees' motion to dissolve the orders of the Superior Court was held, the trustees in bankruptcy of the White House having been authorized by stipulation to intervene as parties. On said day appellees' motion was granted by the District Court and its order issued on March 23, 1965, dissolving all said state Court orders.

This appeal followed.

QUESTIONS INVOLVED

1. Whether pursuant to the Labor Management Relations Act (29 U.S.C. § 141, et seq.) and the national labor policy thereunder, a labor organization representing employees in an industry affecting commerce is entitled to an order either from a state or a federal Court of proper jurisdiction enforcing a collective bargaining contract providing for arbitration of disputes arising thereunder notwithstanding the institution of bankruptcy proceedings by the employer, party to said contract.

2. Whether a suit instituted in state Court under state law to enforce an arbitration provision of a collective bargaining contract in an industry affecting commerce may be removed to a federal District Court and retained therein on the ground that the District Court has original jurisdiction of said action.

SPECIFICATION OF ERRORS

1. The District Court erred when it refused to grant appellants' motion to remand the proceedings to the Superior Court in and for the City and County of San Francisco, State of California.

2. The District Court erred when it refused to sustain the order directing that arbitration proceed issued by the Superior Court in and for the City and County of San Francisco, State of California.

3. The District Court erred when it refused to grant appellants' petition for an order directing that arbitration proceed.

4. The District Court erred when it refused to sustain the issuance of a preliminary injunction by the Superior Court in and for the City and County of San Francisco, State of California.

5. The District Court erred when it refused to grant appellants' petition for a preliminary injunction.

SUMMARY OF ARGUMENT

The Labor Management Relations Act (LMRA) and the interpretation thereof by the Courts and the National Labor Relations Board make it abundantly clear that bankruptcy proceedings were intended to be subordinate and subject to the national labor policy. The LMRA, which specifically refers to and includes trustees in bankruptcy and receivers as persons subject to coverage of the law, recognizes and affirms the

right of parties to collective bargaining agreements to bring suits in state or federal Courts to enforce those agreements. The Courts have consistently held that suits to compel arbitration pursuant to the terms of collective bargaining agreements are included among the types of suits which may be brought in either state or federal Courts.

The arbitration process is accorded a preferred status by both the Courts and the National Labor Relations Board (NLRB) in the resolution of disputes under collective bargaining agreements, with the Courts and the NLRB deferring to the utilization of arbitration in the resolution of such disputes. Recognizing that controversies involving employee rights under collective bargaining agreements may, in fact, survive the cessation of employer operations, arbitration is frequently ordered by the Courts as the proper method of settling contract disputes arising out of the termination of employer operations.

It is clear that the intervention of bankruptcy proceedings may not be used to thwart this affirmative policy favoring arbitration. In view of the express applicability of the LMRA to proceedngs in bankruptcy, actions under that Act to compel arbitration should prevail as against considerations of jurisdiction of the bankruptcy Court in situations involving the resolution of controversies arising under the terms of collective bargaining agreements. That this is the Congressional intent is amply demonstrated by the express language of the LMRA and its interpretation by the Courts and the NLRB.

It is equally clear that the arbitration process is in no way in conflict with orderly administration of the Bankruptcy Act as demonstrated by the decisions of the Courts thereunder.

In accordance with the clear requirements of federal law and policy, the Courts often exercise their traditional and inherent equity power by the use of injunctions whenever the policy favoring arbitration and its use may be threatened by the acts of one party to the collective bargaining agreement. Equity powers are frequently utilized by the Courts to give meaning and effect to their orders relating to the arbitration of controversies.

In accordance with the national labor policy regarding the preferred status to be accorded to the arbitration process and the right of a party to a collective bargaining agreement to enforce agreements relating to the use of arbitration, it is clear that parties to such agreements may bring suit thereon to compel arbitration in either the state or federal Courts. It is well settled law that the plaintiff in such an action may choose the forum for his action and the procedural law upon which he intends to rely. If his choice is to bring an action in a state Court under the procedure provided by state law he may do so and may not be denied this right because the LMRA gives him an additional available forum in the federal Court.

An action to enforce the provisions of a collective bargaining agreement brought in a state Court under state law is not one arising under the LMRA or any

other federal law within the meaning of the Removal Statute (28 U.S.C. § 1441) although the substantive principles of federal labor law and policy are to be applied. Therefore, removal of such a case to a federal District Court is improper.

ARGUMENT

I.

BOTH THE STATE AND FEDERAL COURTS ARE AUTHORIZED BY THE LABOR MANAGEMENT RELATIONS ACT AND THE NATIONAL LABOR POLICY FASHIONED THEREUNDER TO COMPEL AN EMPLOYER TO SUBMIT TO ARBITRATION PURSUANT TO THE TERMS OF A COLLECTIVE BARGAINING AGREEMENT ENTERED INTO BY THAT EMPLOYER AND A LABOR ORGANIZATION, NOTWITHSTANDING THE ADVENT OF BANKRUPTCY PROCEEDINGS INVOLVING THE EMPLOYER.

A. The right of a labor organization to compel an employer, with whom it has entered into a collective bargaining agreement, to submit to arbitration thereunder takes precedence over intervening procedures under the Bankruptcy Act.

The Labor Management Relations Act (LMRA) and the interpretation thereof by the Courts and the National Labor Relations Board (NLRB) make it clear that bankruptcy proceedings were intended to be subordinate and subject to the national labor policy. The Act specifically refers to and includes trustees in bankruptcy and receivers as persons subject to coverage of the law. LMRA § 2(1) (29 U.S.C. § 152(1)); *NLRB v. Coal Creek Coal Co.* (C.A. 10, 1953), 204 F. 2d 579; *NLRB v. Baldwin Locomotive*

Works (C.A. 3, 1942), 128 F. 2d 39; *In re American Buslines* (D.C. Neb. 1957), 151 F. Supp. 877.[2]

In *Baldwin Locomotive Works,* supra, the Court expressly determined that the jurisdiction of a United States District Court in bankruptcy "does not embrace the power" to deal with a debtor's unfair labor practices which affect commerce. (128 F. 2d at 44.) The Court held that under the LMRA the NLRB is granted the power to deal with certain specific problems arising under that Act, and the bankruptcy Court may not interfere with that power. Similarly, in *In re American Buslines,* supra, the federal District Court held that it did not possess the power, as a bankruptcy Court, to command or require a stay of proceedings under the LMRA. The proceedings involved therein were before the NLRB to determine the bargaining representative for employees of a corporation being reorganized. The Court stated:

> "The legislative purpose to include within the employers affected by the Act judicially designated trustees or receivers, *and even by express mention, trustees in bankruptcy,* is thereby made unmistakably clear. *The existence or intervention of bankruptcy,* or corporate reorganization *of an employer is not allowed to deprive his or its employees of the rights defined and assured to them*

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[2]Cf. *Cullen v. Bowles* (C.A. 2, 1945), 148 F. 2d 621, where the Court stated:

> "It has been generally held that federal statutes regulating business in the public interest, are equally applicable when the business is run by trustees or receivers." (Id. at p. 623.)

> *by the Act or to impair, or, as the court is persuaded, to alter the manner of or the forum for the assertion and vindication of those rights."* (151 F. Supp. 886; emphasis supplied.)

That the forum for the assertion and vindication of those other rights granted by the Act, as to which the NLRB is not given specific authority, to wit, suits for violations of collective bargaining agreements (LMRA § 301(a); 29 U.S.C. § 185(a)), includes the state and federal Courts is made unmistakably clear by *Dowd Box v. Courtney*, 368 U.S. 502, 82 S. Ct. 519, 7 L. Ed. 2d 483.

In bankruptcy proceedings under Chapter X of the Bankruptcy Act (11 U.S.C. §§ 501-676), there can be no doubt that the provisions of the LMRA and other federal laws defining the rights of employees clearly prevail. Section 15 of the LMRA (29 U.S.C. § 165) explicitly provides that the LMRA will prevail over the provisions in Chapter X of the Bankruptcy Act.[3]

Even though the bankruptcy Court, in reorganization cases, is given express power to issue stays and injunctions (11 U.S.C. § 513), it has been held that a federal law relating to labor, to wit, the Norris-La

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[3]In 6 *Collier on Bankruptcy*, § 15.14(1) it is stated:

"In addition, it is now clear that corporate reorganization will not prevent the invocation of proceedings before the National Labor Relations Board *or other administrative or judicial proceedings under the Act* to carry out and enforce its terms . . . Section 2(1) of the Labor Management Relations Act *further insures that trustees and receivers are covered by the provisions of the Act.*" (Id. at 5225; emphasis supplied.)

Guardia Act (29 U.S.C. §§ 101-115), takes precedence over bankruptcy proceedings. *Anderson v. Bigelow* (C.A. 9, 1942), 130 F. 2d 460; cert. denied, 317 U.S. 690, 63 S. Ct. 265, 87 L. Ed. 552. See also 6 *Collier on Bankruptcy,* § 3.09, Note 17.

It is also to be noted that under Section 272 of Chapter X of the Bankruptcy Act (11 U.S.C. § 672) employees are guaranteed the untrammelled right to join a labor union of their choice. See Teton, *Reorganization Revised* (1939), 48 Yale L.J. 573, 596. It is likewise clear that a trustee or debtor in possession has the power and right to enter into a collective bargaining agreement with the debtor's employees. *Matter of Wil-Low Cafeterias, Inc.* (C.A. 2, 1940), 111 F. 2d 429.[4] Court supervision of corporate reorganization affords the operating possessor "no freedom from its statutory duties to its employees." *NLRB v. Baldwin Locomotive Works,* supra, at page 43. And a trustee or debtor in possession is not immune from statutory liability to employees under the Fair Labor Standards Act. (29

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[4]The Court said:

> "In these days of collective bargaining between labor unions and corporations it would seem strange that the contract which had been arrived at by negotiation usual in form and substance and relating to ordinary wage arrangements should be held unauthorized . . ." (111 F. 2d at 431-432.)

See also, with respect to the survival and effect of employee pension rights in reorganization proceedings, the decision in *Vallejo v. American R. Co. of Porto Rico* (C.A. 1, 1951), 188 F. 2d 513, *remanded In re American R. Co. of Porto Rico* (D.C. Puerto Rico, 1952), 110 F. Supp. 45, *aff'd* 202 F. 2d 149 (C.A. 1, 1952).

U.S.C. 201, et seq.) *Matter of Fulnau Corp.* (S.D. N.Y. 1943), 49 F. Supp. 570.

The National Labor Relations Board frequently undertakes to carry out its duties under the LMRA, notwithstanding the advent of bankruptcy proceedings. *NLRB v. Coal Creek Coal Co.,* supra; *NLRB v. Baldwin Locomotive Works,* supra; *In re American Buslines,* supra. Moreover, its proceedings in such instances take precedence over the bankruptcy proceedings. In *Nathanson, Trustee v. National Labor Relations Board,* 344 U.S. 25, 73 S. Ct. 80, 97 L. Ed. 23, the Supreme Court held that particular controversies "should be remitted to another tribunal for litigation" (344 U.S. at 30); and, further, that "wise administration . . . demands that the bankruptcy court accommodate itself to the administrative process." (Id. at 30.)

Arbitration is, likewise, an "administrative process" to which bankruptcy proceedings should also defer under federal labor law. *Textile Workers Union v. Lincoln Mills,* 353 U.S. 448, 77 S. Ct. 912, 1 L. Ed. 2d 972; *United Steelworkers v. Warrior & Gulf Nav. Co.,* 363 U.S. 574, 80 S. Ct. 1347, 4 L. Ed. 2d 1409; *United Steelworkers v. Enterprise Corp.,* 363 U.S. 593, 80 S. Ct. 1358, 4 L. Ed. 2d 1424; *United Steelworkers v. American Mfg. Co.,* 363 U.S. 564, 80 S. Ct. 1343, 4 L. Ed. 2d 1403; *Carey v. Westinghouse Electric Corp.,* 375 U.S. 261, 84 S. Ct. 401, 11 L. Ed. 2d 320. It must be concluded that suits to compel arbitration, such as in the instant case, are to be accorded a primary status over bankruptcy proceedings similar

to that accorded to the NLRB, if federal labor policy is to be fully effectuated.[5]

The Courts have recognized that, to fully effectuate the congressional intent manifested by the enactment of the Labor Management Relations Act, certain employee rights transcend the boundaries of corporate existence. Thus, matters for bargaining, to be included in the terms of collective bargaining agreements, and often made mandatory bargaining subjects by the labor law, include those which by their very nature become operative at a time subsequent to the work which earned them. In *Goodall-Sanford Inc. v. United Textile Workers* (C.A. 1, 1956), 233 F. 2d 104, Chief Judge Magruder held that where a collective bargaining agreement gave employees various benefits, such as group life, medical and hospitalization insurance, pensions, and vacation pay, the question of whether the employer had the right to terminate all operations at certain mills and to terminate

[5]In *In re Muskegon Motors Specialties Co.* (C.A. 6, 1963), 313 F. 2d 841, the Court of Appeals held that it was not an abuse of discretion for the District Court to refuse to surrender its jurisdiction in favor of arbitration under the terms of a collective bargaining agreement. A reading of the case indicates that the motivation for the decision was primarily because "labor peace was not an issue" and that the employer "was out of business and had no plant or employees" (supra, at 843). Also, the Court relied upon State Court decisions in Michigan holding that employees had no claim for vacations against an employer who had gone out of business prior to the vacation rights becoming fixed, thus passing on the merits of the arbitration claim, contrary to the principles enunciated by the Supreme Court in *United Steelworkers v. Warrior and Gulf Nav. Co.*, supra. The *Muskegon* case is clearly erroneous in its view of the importance of arbitration of controversies which survive the cessation of the employer's operations. See the subsequent Supreme Court decision in *Republic Steel v. Maddox*, ... U.S. ...., 85 S. Ct. 614, 13 L. Ed. 2d 580.

the employment of employees at those mills was an arbitrable question under the agreement. Judge Magruder stated:

> ". . . in view of the increasingly complex use of compensation in the form of 'fringe benefits', some types of which inherently are not payable until a time subsequent to the work which earned the benefits, we believe that *there may be terms within a union-employer contract whose effect is not necessarily limited to the continuance of the living relationship that exists while the business is being operated as a going concern.*" (223 F. 2d at 110; emphasis supplied.)

This assertion of the national labor policy is particularly apt to the instant case where employees' pension rights are directly involved in the issues sought to be arbitrated. See also *Republic Steel Corp. v. Maddox,* .... U.S. ...., 85 S. Ct. 614, 13 L. Ed. 2d 580 (decided January 25, 1965); *John Wiley & Sons v. Livingston,* 376 U.S. 543, 84 S. Ct. 909, 11 L. Ed. 2d 898; *Wackenhut Corp. v. Guard Workers Local 151* (C.A. 9, 1964), 332 F. 2d 954; *United Furniture Workers v. McCoy-Couch Furniture Mfg. Co.* (E.D. Ark. 1963), 223 F. Supp. 880.

It must be concluded that these important employee rights, including the right of arbitration under a collective bargaining contract, which have been recognized by the Courts as surviving the termination of an employer's operations, may not be destroyed merely because an employer files a voluntary petition in bankruptcy. The national labor policy favoring arbitration as the preferred method of resolving dis-

putes arising under collective bargaining contracts has been manifested by Congress, and this intent of Congress has been respected and enforced by the Courts.

B. Where a Federal Court has jurisdiction under § 301, LMRA, or where a State Court has jurisdiction by virtue of an action brought under State laws, such a Court should order arbitration pursuant to the terms of a collective bargaining agreement even though the employer has ceased operations and has filed a petition in bankruptcy.

It is now beyond argument that the national labor policy requires that disputes between parties to a collective bargaining agreement are to be resolved pursuant to arbitration where the parties have so agreed. *National Labor Relations Act,* § 1 (29 U.S.C. § 151); *Labor Management Relations Act,* §§ 201, 203 (d), 301 (29 U.S.C. §§ 171, 173(d), 185); *Textile Workers Union v. Lincoln Mills,* supra; *United Steelworkers v. Warrior and Gulf Nav. Co.,* supra; *United Steelworkers v. Enterprise Corp.,* supra; *United Steelworkers v. American Mfg. Co.,* supra; *John Wiley & Sons v. Livingston,* supra; *Carey v. Westinghouse Electric Corp.,* supra; *Republic Steel Corp. v. Maddox,* supra; *Grunwald-Marx Inc. v. Los Angeles Joint Board,* 52 Cal. 2d 568, 343 P. 2d 23; *O'Malley v. Wilshire Oil Co.,* 59 Cal. 2d 482, 381 P. 2d 188.

The national labor policy favoring the enforcement of agreements to arbitrate has been uniformly applied by the Courts and the NLRB so as to give precedence to the arbitration process. *Carey v. Westinghouse Electric Corp.,* supra; *Smith v. Evening News Assn.,* 371 U.S. 195, 83 S. Ct. 267, 9 L. Ed. 2d 246; *Drake*

Bakeries v. Local 50, 370 U.S. 254, 82 S. Ct. 1346, 8 L. Ed. 2d 474; *Republic Steel Corp. v. Maddox,* supra; *Raley's Inc. d/b/a Raley's Super Markets,* 143 NLRB No. 40; *Retail Clerks Local 770 v. Thriftimart,* 59 Cal. 2d 421, 380 P. 2d 652; *Spielberg Mfg. Co.,* 112 NLRB 1080.

It is thus clear that arbitration is to be accorded a preferred status under the national labor policy; that status should likewise control proceedings in bankruptcy, insofar as suits in state or federal courts to compel arbitration pursuant to the terms of collective bargaining agreements are concerned.

It is well settled that Congress has the power to vest in other forums jurisdiction over certain proceedings which may arise in the course of the bankruptcy proceedings, and the power to require that the bankruptcy Court *qua* bankruptcy Court surrender its jurisdiction to these other Courts. *Callaway v. Benton,* 336 U.S. 132, 69 S. Ct. 435, 93 L. Ed. 553; *Order of Railway Conductors of America v. Pitney,* 326 U.S. 561, 66 S. Ct. 322, 90 L. Ed. 318; *Thompson v. Magnolia Petroleum Co.,* 309 U.S. 478, 60 S. Ct. 628, 84 L. Ed. 876; *Foust, Admr. of Munson S.S. Lines,* 299 U.S. 77, 57 S. Ct. 90, 81 L. Ed. 49; *Tucker v. Texas American Syndicate* (C.A. 5, 1948), 170 F. 2d 939; *In re Spier Aircraft Corp.* (C.A. 3, 1943), 137 F. 2d 736; *Nathanson, Trustee v. NLRB,* supra; *Milens v. Bostian* (C.A. 8, 1943), 139 F. 2d 282; *Matter of Florida East Coast Ry. Co.* (S.D. Fla. 1943), 49 F. Supp. 527; *Layton v. Thayne* (C.A. 10, 1944), 144 F. 2d 94.

The decisions under the Bankruptcy Act itself lend emphatic support to the contention that the trustees in bankruptcy and the bankrupt corporation may be compelled to submit to arbitration pursuant to the terms of a collective bargaining agreement. In *Tobin v. Plein* (C.A. 2d, 1962), 301 F. 2d 378, the Court of Appeals held that a trustee in bankruptcy's discretion to submit claims to arbitration, founded on § 26 of the Bankruptcy Act (11 U.S.C. 49),[6] does not supersede explicit contractual provisions for arbitration inasmuch as § 26 is clearly drawn to provide arbitration *"where no contractual arrangements exist"*. (Supra, at 381; emphasis supplied.) See also *Schilling v. Canadian Foreign S.S. Co.* (D.C. N.Y. 1961), 190 F. Supp. 462, wherein it was held that § 26 does not give the bankruptcy trustees a right to abrogate agreements for arbitration.[7]

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[6]Section 26 (11 U.S.C. 49) reads:

"(a) The receiver or trustee may, pursuant to the direction of the Court, submit to arbitration any controversy arising in the settlement of the estate.

"(b) Three arbitrators shall be chosen by mutual consent, or one by the receiver or trustee, one by the other party to the controversy, and the third by the two so chosen, or, if they fail to agree in five days after their appointment, the Court shall appoint the third arbitrator.

"(c) The written finding of the arbitrators or of a majority of them as to the issues presented may be filed in court and shall have like force and effect as the verdict of a jury."

[7]In 3 *Collier on Bankruptcy*, § 57.15 (3.3) it is stated:

"That arbitration is in no way opposed to the spirit of the [Bankruptcy] Act is best illustrated by the express recognition in § 57(d) of 'reasonable estimation' as a means of liquidation. Estimation goes, if anything, a step further than arbitration." (At page 243.)

Although the *Schilling* decision, in dictum, implies that the rule would be otherwise where the party seeking arbitration is a creditor of the bankrupt, such dictum must of necessity be confined, if

It is therefore clear that the LMRA and the Congressional intent in its enactment, as manifested by the decisions of the NLRB and the Courts in fashioning a national labor policy, give to the state and federal courts jurisdiction which supersedes the jurisdiction of the bankruptcy Court *qua* bankruptcy Court in suits to compel arbitration under a collective bargaining agreement. This conclusion is reinforced, as noted above, by the decisions under the Bankruptcy Act itself holding that a bankruptcy trustee can be compelled to submit to arbitration under explicit contractual terms.

It is submitted that the District Court below misunderstood its function in relation to the parties and the issues before it. The integrity of the right of arbitration under a contract as expressed in the national labor policy as well as in the Bankruptcy Act itself should have been upheld as against the submergence of those rights in the pending bankruptcy proceedings—a result necessarily flowing from the lower Courts' refusal to require the parties to respect their contract to arbitrate.

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relevant at all, to the usual creditor-debtor situation. In the instant case, the appellants are not creditors in the usual sense and they have behind them a strong and clear federal policy assuring to them their rights as employees and as a labor organization to arbitration of controversies arising pursuant to the terms of a collective bargaining agreement.

C. Inasmuch as applicable Federal law requires the surrender of jurisdiction by the Bankruptcy Court qua Bankruptcy Court to the appropriate State or Federal forum questions concerning arbitration under the terms of a collective bargaining agreement, such other forum may exercise its traditional powers in equity to preserve the status quo or to render effective any decision or award resulting therefrom.

That the state Court had power to issue its injunctions in the instant matter and to take other action pending an abitration proceeding is now firmly established law. *Textile Workers Union v. Lincoln Mills,* supra; *Local Division 1098 etc. v. Eastern Greyhound Lines* (D.C. for D. of C., 1963), 225 F. Supp. 28.[8] The Courts of the State of California have similar powers, traditionally and by statute. *Code of Civil Procedure,* §§ 525-533; *Biasca v. Superior Court,* 194 Cal. 366; *McDonald v. Superior Court,* 18 Cal. App. 2d 652; *Rohrer v. Babcock,* 114 Cal. 124; *Mulvey v. Wangenheim,* 23 Cal. App. 268; *Pasadena v. Superior Court,* 157 Cal. 781.

There was an additional and fundamental reason for the issuance of an injunction in the instant case which clearly justifies the exercise of the equity power of the Court. Appellants seek to have the question of whether or not a valid, specific and enforcible pension trust for the benefit of the employees was, in fact,

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[8]In the *Greyhound* case, supra, Judge Holtzoff, in granting an injunction restraining the employer from moving its repair and maintenance operations from Washington, D.C. to Chicago, Illinois, pending an arbitration between the parties as to whether the employer had such right, declared:

> "If the Court has power to order specific performance of such a covenant, it has collateral power to take steps that would prevent rendering the result of the arbitration futile and ineffective." (Supra, at page 31.)

established pursuant to the terms of the collective bargaining agreement. It is well settled that assets held by the bankrupt in trust are not part of the bankrupt's estate to be administered and distributed by the bankruptcy Court and the trustee in bankruptcy for the benefit of creditors. See *United States Nat. Bank in Johnstown, Pa. v. Blauner's Affiliated Stores* (C.A. 3, 1935), 75 F. 2d 826; *Stickney v. General Electric* (C.A. 4, 1930), 44 F. 2d 362; *Cooper v. Buckley, et al.*, 84 Pa. Super. 83; *Simmermaker v. Intl. Harvester,* 230 Ia. 895, 298 N.W. 911; *Hart v. Roman,* 58 N.D. 516, 226 N.W. 620.

In *Adams v. Champion,* 294 U.S. 232, 79 L. Ed. 880, a trustee in bankruptcy asserted a claim against the receiver of a national bank for the value of property received by the bank as an unlawful preference. The receiver admitted the validity of the claim, if it was placed upon the same level as the claims of creditors at large, but insisted that the claim had priority on the ground that the ''avails of the unlawful preference are subject to a trust". (Supra, at 232.) In finding that the receiver of the bank was merely a bailee and that there was no trust relationship in existence, Mr. Justice Cardozo, speaking for the Court, said:

> "We do not need to consider whether effect would be given to such an agreement according to its form if the bank at that time had been under a present duty to set up a trust as to the proceeds to the use of the bankrupt or of the trustee as his successor. For the purposes of this case we assume, though we do not hold, that *a*

trust in that event would attach to the cash assets in the vaults to an equivalent amount." (Supra, at page 237; emphasis supplied.)

Appellants submit that the facts which are the basis of Justice Cardozo's assumption are precisely those in the case at bar. There is a specific pension trust agreement in existence and the bankrupt corporation failed to make the required payments thereto. It must therefore be concluded that a constructive trust attaches to the bankrupt's funds to the extent of the bankrupt corporation's liability under the trust agreement.[9]

Whether or not a constructive trust, on this theory, can be impressed upon the assets of the corporation is a question that need not now be decided by this Court. The existence of such a trust, as contended by appellants, is, however, a vital reason for the allowance of the injunction in the state Court. In any event, it is for that Court, in the exercise of its equity discretion, to determine whether or not an injunction should issue to protect its order directing that arbitration proceed. It is for the arbitrator to decide whether the collective bargaining agreement

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[9]The Supreme Court decision in *McKey v. Paradise,* 299 U.S. 119, 81 L. Ed. 75, cited by appellees in the court below, is easily distinguishable. In the *McKey* case, by agreement, the employer was to pay part of each employee's wages to a certain welfare association. The Court found that what was otherwise a debt to the employees was to become a debt to the association. It also found that, on the facts, the agreement did not give to the employee or the association equitable title to or lien upon any part of the employer's property. The case at bar is significantly different. Here there was a specific and enforcible trust, as such, created.

by its terms required the employer to establish such a trust fund, and if so, whether the employer violated the agreement in this respect. Should the arbitrator so find, such an award plainly would be barren of any benefit to the injured employees if the Court's injunction were not to remain effective.

II.

A SUIT TO COMPEL ARBITRATION PURSUANT TO THE TERMS OF A COLLECTIVE BARGAINING AGREEMENT BETWEEN AN EMPLOYER AND A LABOR UNION, BROUGHT IN A STATE COURT UNDER STATE LAW, IS NOT ONE FOUNDED ON A CLAIM OR RIGHT ARISING UNDER THE CONSTITUTION, TREATIES OR LAWS OF THE UNITED STATES, SO AS TO MAKE IT REMOVABLE WITHIN THE MEANING OF § 1441(b) OF THE REMOVAL STATUTE.

A. The Labor Management Relations Act does not affect the right of a party to a collective bargaining agreement to bring an action in a State Court for violation of that agreement.

In *Dowd Box v. Courtney,* supra, the United States Supreme Court was presented with the question of whether Section 301(a) of the LMRA, supra, divests a state Court of jurisdiction over a suit for violation of a contract between an employer and a labor organization. The question arose by reason of the fact that a Massachusetts trial Court had rejected an attack upon its jurisdiction in an action by a union against an employer seeking money damages for violation of a collective bargaining agreement, and had subsequently rendered a money judgment in favor of the union. The Supreme Judicial Court of Massachusetts

affirmed,[10] ruling that § 301 had not granted the federal Courts exclusive jurisdiction over suits for violation of labor contracts in industries affecting interstate commerce.

In affirming the Massachusetts Court's ruling, the U. S. Supreme Court said:

> "We start with the premise that nothing in the concept of our federal system prevents state courts from enforcing rights created by federal law. Concurrent jurisdiction has been a common phenomenon in our judicial history, and exclusive federal court jurisdiction over cases arising under federal law has been the exception rather than the rule. . . . The legislative history makes clear that the *basic purpose of § 301(a) was not to limit, but to expand, the availability of forums for the enforcement of contracts made by labor organizations.*" (368 U.S. 502, 507-509, 82 S. Ct. 519, 522-523; emphasis supplied.)
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> "The clear implication of the entire record of the Congressional debates in both 1946 and 1947 is that the purpose of conferring jurisdiction upon the federal district courts *was not to displace, but to supplement, the thoroughly considered jurisdiction of the courts of the vairous states over contracts made by labor organizations.*" (Id. at page 511, 82 S. Ct. page 525; emphasis supplied.)

In the case of *Teamsters Union v. Lucas Flour Co.,* 369 U.S. 95, 82 S. Ct. 571, 7 L. Ed. 2d 593, the Supreme Court applied its decision in *Dowd Box,* supra,

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[10] 341 Mass. 337, 169 N.E. 2d 885.

to the issue raised as to whether a state Court had jurisdiction over a suit for violation of a collective bargaining agreement. In expressly recognizing the right of a party to a collective bargaining agreement to bring a suit for violation thereof in a state court under the common law or statutory jurisdiction of that Court, the Supreme Court held that substantive principles of federal labor law must be applied in suits of a kind covered by § 301 of the LMRA. Thus, while the traditional jurisdiction of the state Courts inheres in suits for violation of collective bargaining agreements, incompatible doctrines of local law must give way to principles of federal labor law. This rationale was based, not on some notion of a greater or higher *jurisdiction* in the federal Courts, but because the subject matter "is peculiarly one that calls for uniform law." 369 U.S. 95, 103.

Other Courts, both state and federal, have held that state Courts have not been deprived of their traditional jurisdiction in suits for violation of collective bargaining agreements by the enactment of § 301 and by the availability of the federal district Courts as an additional forum for the resolution of disputes involving collective bargaining agreements. For *pre-Dowd Box* decisions, see, for example, *Philadelphia Marine Trade Assn. v. International Longshoremen's Assn., Local 1291* (1955), 115 A. 2d 733, 382 Pa. 326, cert. den. 350 U.S. 843, 76 S. Ct. 84, 100 L. Ed. 751; *Ryan Aeronautical Co. v. Intl. Union, United Auto., Aircraft and Agr. Implement Workers, Local 506* (D.C. Cal. 1959), 179 F. Supp. 1; *Minkoff v. Scran-*

ton Frocks Inc. (D.C. N.Y. 1959), 172 F. Supp. 870; *McCarroll v. Los Angeles County District Council of Carpenters* (1957), 315 P. 2d 322, 49 C. 2d 45, cert. den. 355 U.S. 932, 78 S. Ct. 413, 2 L. Ed. 2d 415; *Foley Construction Co. v. Truck Drivers,* Ohio Com. Pl. 1960, 172 N.E. 2d 170. For *post-Dowd Box* decisions upholding the traditional exercise of jurisdiction by the state Courts, see, for example, *Humphrey v. Moore* (1964), 375 U.S. 335, 84 S. Ct. 363, 11 L. Ed. 2d 370, rehearing denied 376 U.S. 935, 84 S. Ct. 697, 11 L. Ed. 2d 655; *Milk Drivers and Dairy Emp. Union Local 338 v. Dairymen's League Co-op.* (C.A. N.Y. 1962), 304 F. 2d 913; *St. Louis Mailer's Union, Local 3 v. Globe Democrat Pub. Co.* (D.C. Mo. 1964), 233 F. Supp. 529; *Independent Oil Workers v. Socony Mobil Oil Co.* (1964), 205 A. 2d 78, 85 N.J. Super. 453; *Morceau v. Gould-National Batteries, Inc.* (1962), 181 N.E. 2d 664, 344 Mass. 120; *Gage Plumbing Supply Co. v. Local 300* (1962), 20 Cal. Rptr. 860, 202 C.A. 2d 197, 92 A.L.R. 2d 1223; *Operating Engineers, Local Union 3 v. Pittsburgh-Des Moines Steel Co.,* (D.C. Cal. 1965), ... F. Supp. ...., (Civil No. 43,118, dated February 9, 1965).

Appellants commenced this suit in the Superior Court in and for the City and County of San Francisco and relied on the provisions of state statutory law for the commencement of the suit, to wit, Sections 1280 et seq. of the Code of Civil Procedure of the State of California. The Supreme Court and the decisions of the lower courts in accord have made it overwhelmingly clear that they have a right to do so.

B. A Federal District Court does not have original jurisdiction of a suit for violation of a collective bargaining agreement brought in a State Court under State law and a motion to remand the proceedings to the State Court, after the filing of a petition for removal to the District Court, should be granted.

The District Court's denial of appellants' motion to remand the proceedings to the state Court, after a petition for removal to the federal Court had been filed by appellees, rendered ineffectual the Congressional policy intended to have § 301(a) "supplement" and "not to displace" or "to encroach upon the existing jurisdiction of the state courts" in suits for violation of collective bargaining agreements in industries affecting commerce.[11] Further, the District Court's denial of remand had the inevitable consequence of ousting the state Court of its jurisdiction in a field not preempted by Congress, in contravention of the historic comity doctrine which proscribes avoidable direct conflicts between federal and state Courts.

For the petition for removal in the instant case to have been properly granted the action must come within the terms of the Removal Statute, 62 Stat. 937; 28 U.S.C. § 1441.[12]

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[11] *Dowd Box v. Courtney*, supra, at pages 488, 489.

[12] Section 1441 reads:

"(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a state court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending.

"(b) Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under

The District Court in the instant case evidently and erroneously premised its denial of remand on the ground that it had *original jurisdiction* under § 301(a) of the Labor Management Relations Act, of a suit for violation of a labor contract, and that § 1441(b) of the Removal Statute therefore permits the removal to a federal District Court of a civil action of which it has jurisdiction under a law of the United States.

While it is clear that federal substantive law applies in suits for violation of collective bargaining agreements (*Textile Workers Union v. Lincoln Mills,* supra), the transcending question involved here is whether the action commenced in the state Court was "founded on a claim or right arising under the Constitution, treaties or laws of the United States", so as to make it removable, within the meaning of § 1441(b) of the Removal Statute. Reversal of the denial of remand will be required if the removed state action was *not* "founded on a claim of right arising

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the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties. Any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the state in which action is brought.

"(c) Whenever a separate and independent claim or cause of action, which would be removable if sued upon alone, is joined with one or more otherwise non-removable claims or causes of action, the entire case may be removed and the district court may determine all issues therein, or, in its discretion, may remand all matters not otherwise within its original jurisdiction." June 25, 1948, c. 646, 62 Stat. 937, 28 U.S.C. § 1441.

under" § 301(a) of the Labor Management Relations Act.[13]

The Supreme Court in 1821 was first called upon to decide when a case "arises under a law of the United States." In the landmark case of *Cohens v. Virginia,* 6 Wheat. 264, 5 L. Ed. 257, Mr. Chief Justice Marshall, speaking for the Court said:

> "A case in law or equity consists of the right of one party, as well as of the other, and may truly be said to arise under the constitution or a law of the United States, *whenever its correct decision depends on the construction of either.*" (6 Wheat. 264 at 369; emphasis supplied.)

In so holding the Supreme Court rejected the contention that a case *arises* under the Constitution or a law of the United States *merely* because it is founded on a right conferred by the Constitution or a federal law.

The Supreme Court amplified this rule three years later in *Osborn v. Bank of United States,* 9 Wheat. 738, 6 L. Ed. 204 (1824). Chief Justice Marshall, again speaking for the Court, stated that a case arises under the constitution or laws of the United States when *"the title or right set up by the party may be defeated by one construction of the constitution or law of the United States and sustained by the opposite*

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[13]In *American Dredging Co. v. Local 25, Marine Div., Int. Union of Op. Engineers* (C.A. 3, 1964), 338 F. 2d 837, it was stated:

> "In a removal proceeding under § 1441 that statute must be harnessed in a real sense to the specific federal law (here § 301(a)) relied upon as conferring original jurisdiction upon the District Court." (Page 848.)

construction." (9 Wheat. at 822; emphasis supplied.) See also *Little York Goldwashing & Water Co., Ltd. v. Keyes,* 96 U.S. 199, 24 L. Ed. 656 (1878); *Storin v. New York City,* 115 U.S. 248, 6 S. Ct. 28, 29 L. Ed. 388 (1885).

Shultis v. McDougal, 225 U.S. 561, 32 S. Ct. 704, 56 L. Ed. 1205, decided in 1912, is another case wherein the Supreme Court, following its declaration that jurisdiction cannot rest on any ground that is not affirmatively and distinctly set forth in the complaint, stated:

> "A suit to enforce a right which *takes its origin* in the laws of the United States is not necessarily, or for that reason alone, one *arising* under those laws, for a suit does not so arise *unless it really and substantially involves a dispute or controversy respecting the validity, construction, or effect of such a law, upon the determination of which the result depends.*" (225 U.S. at 569, 32 S. Ct. at 706; emphasis supplied.)

In *Gully v. First National Bank in Meridian,* 299 U.S. 109, 57 S. Ct. 96, 81 L. Ed. 70 (1936), where the doctrine of *Shultis,* supra, and its predecessors, was cited with approval by the Supreme Court in reversing for failure to remand a removed case to the state Court, it was declared:

> "How and when a case arises 'under the Constitution or laws of the United States' has been much considered in the books. Some tests are well established. *To bring a case within the* [*removal*] *statute, a right or immunity created by the Constitution or laws of the United States*

must be an element, and an essential one of the plaintiff's cause of action. [Citing *Starin,* supra, and *First National Bank of Canton, Pa. v. Williams,* 252 U.S. 504, 512, 40 S. Ct. 372, 64 L. Ed. 690 (1920).] The right or immunity must be such that it will be supported if the Constitution or laws of the United States are given one construction or effect, and defeated if they receive another [citing cases]. *A genuine and present controversy, not merely a possible or conjectural one, must exist with reference thereto* [citing cases], *and the controversy must be disclosed upon the face of the complaint, unaided by the answer or by the petition for removal.* [Citing cases]." (Id. at 113; emphasis supplied.)

It must be assumed that Congress, when it revised the Removal Statute in 1948, was fully aware of the Supreme Court's long and consistent construction of the phrase "arising under the Constitution or laws of the United States."[14]

The decision of the Supreme Court in 1961 in *Pan American Petroleum Corp. v. Superior Court of Delaware,* 366 U.S. 656, 662-663, 81 S. Ct. 1303, 6 L. Ed. 2d 584, is of compelling significance in the instant case. There, in re-affirming the doctrines elaborated

[14]It was stated in *American Fire & Casualty Co. v. Finn,* 341 U.S. 6, 10, 71 S. Ct. 534, 95 L. Ed. 702 (1951), that one of the main purposes of the 1948 revision of the Removal Statute was to further limit removal of cases from the state courts. Prior to 1948, the Court, in holding that removal statutes must be strictly construed by the courts, noted: ". . . the Congressional purpose to restrict the jurisdiction of the federal courts on removal." See *Shamrock Oil & Gas Corp. v. Sheets,* 313 U.S. 100, 108, 61 S. Ct. 868, 872, 85 L. Ed. 1214 (1941).

upon in *Gully v. First National Bank in Meridian,* supra, and its predecessors, these settled jurisdictional principles were stated and applied:

1. ". . . [Q]uestions of exclusive federal jurisdiction *and ouster of jurisdiction of state courts are,* under existing jurisdictional legislation, *not determined by ultimate substantive issues of federal law."* (Id. at p. 589; emphasis supplied.)

2. "The answers depend on *the particular claims a suitor makes in a state court—on how he casts his action.* Since *'the party who brings a suit is master to decide what law he will rely upon.' The Fair v. Kohler Die & Specialty Co.,* 228 U.S. 22, 25, 33 S. Ct. 410, 411, 57 L. Ed. 716". (Id. at 589; emphasis supplied.)

3. It is "immaterial . . . that the plaintiff could have elected to proceed on a federal ground", and *"if the plaintiff decides not to invoke a federal right, his claim belongs in a state court."* (Id. at 589; emphasis supplied.)

4. *"It is settled doctrine that a case is not cognizable in a federal trial court, in the absence of diversity of citizenship, unless it appears from the face of the complaint* that determination of the suit depends upon a question of federal law . . ." (Id. at 589; emphasis supplied.)

5. "Apart from diversity jurisdiction, *'a right or immunity created by the Constitution or laws of the United States must be an element, and an essential one, of the plaintiff's cause of action . . . and the controversy must be disclosed upon the face of the complaint, unaided by the answer or by the petition for removal . . .'* " (Citing *Gully v. First National Bank,* supra.) (Id. at 589; emphasis supplied.)

Applying the principles stated above to the instant case it must be concluded that it was not a case "arising under" § 301(a) of LMRA or any other law of the United States, so as to permit removal under § 1441, since the petition and complaint in the state Court was cast solely on a state created right to bring suit for violation of a collective bargaining agreement and sought only a remedy under state law. There is nothing in the petition and complaint which even remotely suggests that appellants were asserting a claim based on § 301(a), or that it presented a dispute or controversy respecting the validity, construction, or effect of § 301(a) "upon the determination of which the result [of the suit] depends." *Shultis v. McDougal,* supra, at page 706.

The denial of remand by the District Court denied to appellants their right, under settled law, to cast their action on state-created rights rather than on rights available under federal law, to wit, § 301(a). The lower Court's denial of remand deprived appellants of their right to proceed in a state Court by ignoring the specific holding in *Dowd Box,* supra, that Congress, in enacting § 301(a), did not make that statute's jurisdiction exclusive, nor did it intend "to deprive a party to a collective bargaining contract of the right to seek redress for its violation in an appropriate state tribunal." (Id. at 507, 82 S. Ct. at 522.)

Moreover, the denial of remand ousted the state Court of its jurisdiction not only in contravention of the historic comity doctrine which proscribes avoidable conflicts between federal and state Courts, but in

disregard of the specific holding in *Dowd Box,* supra, that Congress did not intend in § 301(a) "to deprive the state courts of a substantial segment of their established jurisdiction over contract actions."[15]

To hold that § 1441 may be utilized to defeat the clearly stated Congressional purpose in enacting § 301(a) would be to mock reason and deny justice where, as here, the complaint was based solely on state-created rights and did not raise any issue with respect to the validity, construction or effect of § 301(a).

It must be concluded that the action properly belongs in the state Court, and that the District Court below erred in denying appellants' motion for remand

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[15]The quoted statement appears in the following sentence a 368 U.S. page 508, 82 S. Ct. at page 523:

> "To hold that § 301(a) operates to deprive the state court of a substantial segment of their established jurisdiction ove contract actions would thus be to disregard this consisten history of hospitable acceptance of concurrent jurisdiction.

The comity principle was stated in *Covell v. Heyman,* 111 U.S. 176 4 S. Ct. 355, 28 L. Ed. 390 (1884) as follows:

> "The forbearance which courts of coordinate jurisdiction administered under a single system, exercise towards eac other, whereby conflicts are avoided, by avoiding interferenc with the process of each other, is a principle of comity wit perhaps no higher sanction than the utility which comes fron concord; but between state courts and those of the Unite States, it is something more. *It is a principle of right and o law, and, therefore, of necessity. It leaves nothing to discretio or mere convenience.*" (Supra, at 182, 4 S. Ct. at 358; em phasis supplied.)

See also *Shamrock Oil & Gas Corp. v. Sheets,* supra, at footnote 1 citing *Healey v. Ratta,* 292 U.S. 263, 270, 54 S. Ct. 700, 703, 7 L. Ed. 1248 to the effect that "[d]ue regard for the rightful inde pendence of state governments, which should actuate federal court requires that they scrupulously confine their own jurisdiction t the precise limits which the statute has defined." And see *America Dredging Co. v. Local 25, Marine Div., Int. U. of Op. Engineer* (C.A. 3, 1964), 338 F. 2d 837, at Note 20, page 847.

CONCLUSION

For the foregoing reasons it is respectfully sub-
nitted that his Court should reverse the orders of the
)istrict Court below and remand the cause to the Dis-
rict Court with directions to enter a judgment in
avor of petitioners, Walter Johnson, individually and
s Secretary-Treasurer of Department Store Em-
loyees Union, Local 1100, and its members, and
Villiam Silverstein, individually and as Secretary-
'reasurer of Retail Shoe & Textile Salesmen's Union,
ocal 410, and its members, and against respondents
aphael Weill & Co., Inc., and respondents by inter-
ention John M. England, C. E. Strobel, and Walter
. Hempy, as trustees in bankruptcy, declaring and
inding that petitioners are entitled by law to compel
aid respondents to submit to arbitration pursuant
o the terms of a collective bargaining agreement, not-
vithstanding the advent of bankruptcy proceedings.
The District Court below should also be directed to
nter an order remanding the proceedings herein to
he Superior Court of the State of California, in and
or the City and County of San Francisco, upon a
inding that petitioners' suit is not a proper one for
emoval to the federal District Court.

Dated, San Francisco, California,
July 19, 1965.

Respectfully submitted,

CARROLL, DAVIS, BURDICK & McDONOUGH,
By ROLAND C. DAVIS,
Attorneys for Appellants.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Roland C. Davis,
Attorney for Appellants.

Nos. 20085 and 20086

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

v.

LILLIAN E. YAEGER,

Respondent

EMMA M. HEBER AND ESTATE OF HENRY D. HEBER, DECEASED,
EMMA M. HEBER, ADMINISTRATRIX,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

REPLY BRIEF FOR THE COMMISSIONER AS PETITIONER

RICHARD M. ROBERTS,
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IN THE UNITED STATES COURT OF APPEALS

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No. 20085

COMMISSIONER OF INTERNAL REVENUE,

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Respondent

REPLY BRIEF FOR THE COMMISSIONER AS PETITIONER

The Commissioner's principal contentions--that Mrs. Heber's share ' rental income from the Fullerton properties, which she received in)56 through 1958, is taxable as ordinary income rather than as capital iin--and the Commissioner's alternative argument--that, if this Court verses the Tax Court on Mrs. Heber's appeal, the Tax Court should also reversed on the Commissioner's appeal against Miss Yaeger--have been illy set forth in our main brief (pp. 18-29).

In the brief filed on behalf of Miss Yaeger, however, an argument ; advanced (Br. 25-29) that the Tax Court should have allowed

eductions to Miss Yaeger in 1955 and 1957 in the amounts of $9,086.39 nd $3,766.32, respectively. Miss Yaeger raised the question of these eductions in her petition to the Tax Court (I-R. 2), but thereafter ailed to discuss the issue in any pleadings or briefs before the Tax ourt. Consequently, the Tax Court in its opinion stated (I-R. 74):

> Since Yaeger has made no argument on brief concerning respondent's disallowance of the deductions she claimed during the years 1955 and 1957 for payments made by her to Heber in the respective amounts of $9,086.39 and $3,766.32, pursuant to the judgment in Steeve v. Yaeger, supra, we conclude that she has abandoned this issue.

'hereafter, Miss Yaeger filed no motions for reconsideration or to amend, ınd her counsel agreed to the computation for entry of decision. (I-R. 37.) She filed no petition for review of the issue with this Court.

It therefore appears that counsel for Miss Yaeger was negligent in not pursuing in the Tax Court her claim with respect to these deductions.*/ However, the Commissioner concedes that the deductions should be allowed to Miss Yaeger on the basis of the Tax Court's opinion. The reason they were not allowed in the computation for entry of decision is that there was some doubt as to the propriety of such a procedure in view of that part of the Tax Court's opinion regarding abandonment

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*/ Shedd's Estate v. Commissioner, 320 F. 2d 638 (C.A. 9th); Inman-Poulsen Lumber Co. v. Commissioner, 219 F. 2d 159 (C.A. 9th); United States v. Waechter, 195 F. 2d 963 (C.A. 9th); Schoenfeld v. Commissioner, 103 F. 2d 964 (C.A. 9th); Kottemann v. Commissioner, 81 F. 2d 621 (C.A. 9th); Ernest Holdeman & Collect, Inc. v. Commissioner, 290 F. 2d 3 (C.A. 7th); Kamen Soap Products Co. v. Commissioner, 230 F. 2d 565 (C.A. 2d); McDonald v. Commissioner, 214 F. 2d 341 (C.A. 2d); Yiannias v. Commissioner, 180 F. 2d 115 (C.A. 8th); Home Furniture Co. v. Commissioner, 168 F. 2d 312 (C.A. 4th); Commissioner v. Josephs, 168 F. 2d 233 (C.A. 8th).

of the deduction issue. To prevent a miscarriage of justice, we suggest that, in the event this Court affirms the Tax Court's decision in the Heber case, the Yaeger case should be remanded for modification of the Tax Court's decision.

Respectfully submitted,

RICHARD M. ROBERTS,
Acting Assistant Attorney General.

LEE A. JACKSON,
MELVA M. GRANEY,
CAROLYN R. JUST,
Attorneys,
Department of Justice,
Washington, D. C. 20530.

JANUARY, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ________________ day of ____________________, 1966.

CAROLYN R. JUST
Attorney.

Nos. 20085 and 20086

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LILLIAN E. YAEGER,

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ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT

OF THE UNITED STATES

BRIEF FOR RESPONDENT YAEGER

RICHARD A. RATTRAY
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Counsel for Respondent Yaeger

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IN THE UNITED STATES COURT OF APPEALS

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Petitioners,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT

OF THE UNITED STATES

BRIEF FOR THE RESPONDENT YAEGER

STATEMENT DISCLOSING BASIS OF JURISDICTION

OF THE TAX COURT AND OF THE COURT OF

APPEALS OF THE NINTH CIRCUIT

Respondent is an individual taxpayer residing in the City of Fullerton, California.

The respondent, Lillian E. Yaeger, an unmarried woma filed timely cash basis personal income tax returns for le calendar years, 1956, 1957 and 1958 (the years here invo with the istrict Director of Internal Revenue in Los An California, and paid to the said District Director the t for by the said returns. The District Director of Intera Revenue at Los Angeles, California, and the collection ds administered by him is within the jurisdiction of the Unt States Court of Appeals for the Ninth Circuit. Taxpayer petition to the Tax Court of the United States (Tr. Vol PP1-14) set out all of the pertinent jurisdictional allea- tions.

Pursuant to the taxpayers petition to the Tax Courto the United States and the resulting decision rendered by th Court in Lillian E. Yaeger v. Commissioner of Internal Reve T.C. Docket No. 4496-62, Commissioner of Internal Revenu filed a petition for review. (Tr. Vol. I, PP97-100).

The above case was consolidated for trial purposes in the Tax Court of the United States with a companion case Heber, et al v. Commissioner of Internal Revenue, T.C. Docket No. 4543-62. Mrs. Heber had also filed a petitio with the Tax Court of the United States involving deficienc arising out of the same facts as the respondent's petition. The Commissioner of Internal Revenue had taken diametricall opposed position in the two cases, and they were consolidat for trial in the Tax Court. As a result of the decisio

therein, Mrs. Heber also filed a Petition for Review (Tr. Vol. I, PP104-212) and again the two cases have been consolidated for appeal before the United States Court of Appeals for the Ninth Circuit (Tr. Vol. I, PP135-137). Jurisdiction in both appeals is conferred upon this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

The instant cases arose out of the same basic fact situation in which Mrs. Heber and Miss Yaeger, who had been partners in the ownership of certain real property, terminated this relationship in 1944 by executing an agreement dividing the properties whereby Mrs. Heber received a vested interest of a life estate in an undivided one-half of the properties as subsequently interpreted and adjudicated by California State Court and the questions are now presented as follows:

1. Can Miss Yaeger be taxed on the income from one-half of the properties which the State Court of California has determined to be the property interest of Mrs. Heber?

2. Should the Tax Court's decision be now modified to permit deductions for Miss Yaeger in the years 1955 and 1957 which were directly consistent and allowable on the basis of the Tax Court's finding that Mrs. Heber did own an undivided one-half interest in the properties?

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) General Definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * *

* * *

(5) Rents;

* * *

* * *

(26 U.S.C. 1958 ed., Sec. 61.)

STATEMENT OF FACTS

Mrs. Heber and Miss Yaeger had been friends and companions for many years. They resided together beginning with the year 1935 and continued to reside together until shortly before Mrs. Heber's marriage in 1947 to her now deceased husband. Mrs. Heber has been a registered nurse since 1927 and Miss Yaeger has dealt in real property both as a manager and a broker for fifty years.

In 1939 the parties entered into an equal partnership whereby they acknowledged that they were to be equal owners of certain properties described therein as Parcels 1 and 2. The agreement provided that the partnership was intended to acquire additional properties and

that the partners were to manage and develop these properti for the equal benefit of both. Further provided that if either party wished to withdraw from the partnership, said partner must first offer to sell or purchase the one-half partnership interest owned by the other party and that in the event that no agreement of sale or purchase could be arrived at by the parties, the partnership was to be dissol and the proceeds thereof divided equally between the partne (Tr. Vol. I, PP52-53).

Parcels 1 and 2 were occupied by building improvements thereon and were regularly rented to produce partnership rental income. During the subsequent course of the partnership activities the partnership acquired a liquor store and certain unimproved lots which were non-income producing and designated as Parcels 3, 4, 5 and 6. During early 1944 the partnership also acquired some property designated as Parce 7 which contained a number of citrus trees but was not productive of income. (Tr. Vol. I, PP53-54.)

August 10, 1944, Mrs. Heber and Miss Yaeger executed a termination agreement, the meaning and interpretation of which have caused controversy in these tax cases here consolidated for review. The agreement recited there had been a partnership and set forth a description of the Parce 1 through 7 then owned as partnership property. It recited that for various reasons legal title was not in the partnership name but was in each case being held for the benefit o

the partnership. The agreement then went on to recite t the parties desired to change their relationships and to partition and divide the properties whereby the legal ti in each piece of property would be vested in Lillian E. Yaeger but "reserving a life estate in and to one-half o the rents, issues and profits to the party of the second part for and during the period of her natural life" (Par of the second part being Mrs. Heber).

The agreement went on to provide in Paragraph 4 tha except as to the liquor store which was to be disposed o the co-partnership agreement previously entered into by the parties would not apply to the future activities reg Parcels 1 through 7. Paragraph 5 provided that all the Parcels would be disposed of except Parcels 1 and 2 and the proceeds therefrom would be applied to reduce the in ness on Parcels 1 and 2 thereby maximize the rental inco from Parcels 1 and 2.

The agreement further provided that in the event th one-half of the net income of the properties was insuffi to care for the parties respectively by reason of illnes want or other necessity or to obtain necessary medical c other assistence for or during the periods of illness, w or other necessity, then the parties agreed to use so mu of the principal or corpus of the properties described a would be necessary to care for the party in need.

Besides providing for a monthly drawing account aga

the annual net rentals of one-half due to each party the agreement also provided in Paragraph 10 that no future indebtedness could be created or incurred on the properties without the express consent of both parties. Paragraphs 11 and 12 provided for accurate books of account and that proper accounting statements would be rendered for the benefit of both parties on an annual basis. (Tr. Vol. I, PP54-56 and PP118-125.)

Deeds were recorded in accordance with the termination agreement. Thereafter at all times relevant hereto Miss Yaeger continued to manage and control the Fullerton properties spending her time and efforts in keeping the properties rented, paying the expenses and supervising the maintenance and upkeep of the properties in general for the benefit of both parties. (Tr. Vol. I, PP57)

Miss Yaeger's purpose in causing Mrs. Heber to execute the termination agreement was to reshuffle their interests in the partnership properties in order to reflect the fact that Mrs. Heber, because of illness, had become unable to assist Miss Yaeger in any of the affairs of the partnership. When Mrs. Heber and Miss Yaeger executed the termination agreement, it was the belief and intention of each of them that the partnership theretofore existing between them was thenceforth terminated. Each of them was aware at that time that Miss Yaeger was receiving thereby a life estate in an undivided one-half of the properties, measured by Mrs. Heber

life, plus the entire ownership of the properties upon Mrs. Heber's death. (Tr. Vol. I, PP51-58)

Thereafter Miss Yaeger managed the properties for the benefit of both parties and paid Mrs. Heber her monthly drawing against her one-half share of the net income of the Fullerton properties until 1948. Miss Yaeger then ceased paying monies to either herself or Mrs. Heber as a drawing against their respective shares of net income from the properties. Miss Yaeger did begin paying herself a manager's salary of $200.00 per month for maintaining the rental properties. All other rental monies received were being utilized to either pay expenses of keeping up the properties or to reduce the indebtedness against them. (Tr. Vol. I, PP.58)

In January, 1949, Mrs. Heber became discontented with Miss Yaeger's management of the properties and sought legal counsel. Settlement negotiations were attempted but in August, 1949, Mrs. Heber initiated proceedings against Miss Yaeger in the Superior Court in and for the County of Orange, State of California, whereby she sought to rescind the termination agreement, reform it, obtain declaratory relief as to its meaning and terms and to quiet title in the property. The Court, in its unrep opinion primarily determined that Mrs. Heber had a vested life estate as an undivided one-half interest in the Ful properties for and during her life and that Miss Yaeger ha

not remitted Mrs. Heber's one-half share of the net income derived from that property interest of Mrs. Heber. This decision was appealed on several grounds by Miss Yaeger, the results of which were reported by the District Court of Appeals, Fourth District, California, and entitled Steeve v. Yaeger, 145 Cal. App. 2d 455, 302 P. 2d 704 (1956). This decision clearly affirmed the lower courts findings of fact and application of law in the State of California and Mrs. Heber was clearly possessed of an undivided one-half life estate in the Fullerton properties. (Tr. Vol. I, PP58-60).

Miss Yaeger paid the amounts awarded to Mrs. Heber pursuant to this judgment, as follows (I-R. 60):

Year Paid		Payments on Judgment	Interest
1955		$ 9,086.39	--
1957		18,007.06	$5,509.30
	Total	$27,093.45	$5,509.30

Because Miss Yaeger had previously reported some of this income now paid to Mrs. Heber in her own returns during the years, 1944 to 1952, Miss Yaeger deducted that portion of income so reported and paid to Mrs. Heber on Miss Yaeger's 1955 and 1957 returns. These deductions were accepted by the Commissioner but later disallowed as being inconsistent with the asserted deficiencies herein involved and based on the contention by the Commissioner that Miss Yaeger was in fact chargeable with income for tax purposes derived from the one-half interest owned by Mrs. Heber. (Tr. Vol. I, PP.10 and 13).

Thus the case has now evolved wherein the Tax Court

found that the deficiencies asserted against Mrs. Heber were correct in assessing a tax to her as a recipient of ordinary income derived from her undivided one-half life estate interest in the Fullerton properties. The Court has further found in effect that Miss Yaeger was not taxable on this same income but was taxable only as to he own undivided one-half interest in the Fullerton properti during the life of Mrs. Heber. However, the Tax Court op did assume that Miss Yaeger abandoned her deductions clai in 1955 and 1957 and therefore a portion of the deficienc asserted by the Commissioner against Miss Yaeger have bee included in the Tax Court's decision.

SPECIFICATION OF ERROR RELIED ON BY RESPONDENT

The Respondent, Yaeger, appears here primarily to re pond to the Commissioner's specification of error that in the event this Court determines that Mrs. Heber is not ta on one-half of the income from the Fullerton Properties spite of her life estate ownership interest therein, the should be taxed to Miss Yaeger. To this extent, of cour the Respondent here urges that no error was made by the Court below.

However, for the facts and reasons set forth hereafe as Argument II, the Respondent does urge that an error wa made by the Tax Court in assuming that Miss Yaeger had abandoned her issues regarding deductions in the year 195 and 1957 when in fact these deductions were not separate

issues to be decided but should have automatically been sustained and included in the Court's determination and holding on the issue that Mrs. Heber was taxable on one-half of the income from the Fullerton Properties.

SUMMARY OF ARGUMENT

1. Mrs. Heber's share of the rental income from the Fullerton Properties which she received from Miss Yaeger unde the terms of a California court judgment during 1955, 1956 ar 1957 was taxable to her as ordinary income as determined fror the facts submitted to this Court, including the interpretation of the Agreement between the parties dated August 10, 1944, the Tax Court properly found that Mrs. Heber did in fact own an undivided one-half life estate in the Fullerton Properties during the taxable years for which the payments were made to Mrs. Heber. Mrs. Heber has not demonstrated that these facts as determined by the Tax Court are clearly erroneous or should now be set aside by this court.

The Tax Court's opinion is consistent with the findings and opinion of a California court wherein the parties had previously litigated the nature and extend of the property herein controlling the tax consequences complained of by Heber. Mrs. Heber accepted the fruits and benefits of the state court's decision as to her property interest and income earned therefrom but now wishes to relitigate the matter as t tax consequences.

The Respondent submits that the state court's determinat of the property interests is now binding on the parties and

also that the Tax Court could not have refused to recogni[illegible] and accept the property interests found by the state cou[illegible] The facts as found by the Tax Court would not warrant th[illegible] argument that the state court decision between the parti[illegible] was collusive or non-adversary and therefore need not be followed by the Tax Court. Also, the facts do not warra[illegible] Mrs. Heber's arguments that in reality she received some[illegible] else different from a life estate interest in the proper[illegible] The law of taxation respects the argument that substance[illegible] control over form but the economic realities of this cas[illegible] clearly reflect that Mrs. Heber did in fact enjoy all of[illegible] benefits and also suffer the burdens and risks of an own[illegible] interest in the Fullerton Properties. Thus, regardless [illegible] characterization of how Mrs. Heber acquired her interest[illegible] by purchase, partnership distribution, or as consideratio[illegible] exchange of her former interests, Mrs. Heber did own and possess the property interest. She in fact continued to [illegible] the same benefits of income that she had previously enjo[illegible] a partner in the Fullerton Properties.

2. Regarding the Respondent's specification of error [illegible] appeal, Miss Yaeger seeks to correct the error by the Ta[illegible] in assuming that she had abandoned certain deductions. [illegible] the property of the deductions had already been accepte[illegible] Commissioner prior to this tax case and were herein dis[illegible] only as a part of the basic issue regarding the taxabil[illegible] Mrs. Heber's interest in the Fullerton Properties. As [illegible] the Tax Court, the deductions should have been allowed [illegible] Mrs. Heber owned a one-half life estate in the properti[illegible]

ARGUMENT

I

THE TAX COURT'S DETERMINATION THAT HEBER'S RECEIPT OF MONEYS FROM THE FULLERTON PROPERTIES WAS AS AN OWNER OF A LIFE ESTATE IN SAID PROPERTIES AND THEREFORE TAXABLE TO HEBER AS ORDINARY INCOME IN THE YEAR OF RECEIPT WAS CORRECT AND PROPERLY SUPPORTE IN FACT AND IN LAW.

On Appeal here, Mrs. Heber contends in her brief (H. Br., 8, 23 and 27) that the Tax Court's determination that the money received by Heber were ordinary income to her because they were paid to her as owner of a life estate interest in the Fullerton properties was incorrect. Mrs. Heber asserts that the Tax Court's findings and its opinion based thereon are not supported by the facts or law applicable thereto. The Respondent submits that the Tax Court's decision was correct and that Mrs. Heber's contention in this regard is not supported by the record now before this Court.

A. The Tax Court Held that From all the Facts Before the Court, Mrs. Heber was the Owner of a Life Estate in an Undivided One-half Interest in the Fullerton Properties

The Tax Court in its Opinion (Tr. Vol. I, PP. 69-70) stated that upon examination of all of the facts before it, it was clear that after the execution of the termination agreement (Ex. 9-I, Tr. Vol. I, PP. 118-125) by Mrs. Heber (i. e., Steeve) and the Respondent, Miss Yaeger, Mrs. Heber was left with a life estate in an undivided one-half of the former partnership properties. The Court further stated that as a result of the same document, Miss Yaeger was left as tenant in common with Mrs. Heber, with a life estate measured by Mrs. Heber's life in the same properties as to an

undivided one-half interest and a future interest in the entire remainder of the properties. These conclusions a clearly supported by the Court's Findings of Facts as follows:

(1) Tr. Vol. I, PP. 54, 55 and 56 - The Agree of August 10, 1944, provided that the parties, Mrs. Hebe and Miss Yaeger, agreed to divide all of the real proper known as the Fullerton Properties whereby fee title woul vested in Miss Yaeger subject to a life estate in and to half of the rents, issues and profits to Mrs. Heber for during the period of her (Mrs. Heber's) natural life. T included seven parcels of land.

(2) Tr. Vol. I, PP. 56 and 57 - Pursuant to t execution of the Agreement of August 10, 1944, deeds wer executed and recorded to convey the exact interests defi above whereby Mrs. Heber received a life estate to one-h of the income of parcels one through seven.

(3) Tr. Vol. I, PP. 9 - The Court found that of the parties was aware at the time the Agreement of Au 10, 1944, was executed that Mrs. Heber was receiving a l estate in an undivided one-half of the properties, measu by Heber's life.

These findings were based on uncontroverted eviden either stipulated to or admitted during the course of th proceedings before the Tax Court. Regarding the Agreem August 10, 1944, it is set forth in the record herewith Tr. Vol. I, PP. 118 to 126. The deeds referred to were

stipulated to by all parties as set forth in Stipulation of Facts (Tr. Vol. I, PP. 44, 45 and 46 and specifically as Exhibits 10-J, 11-K, 12-L and 13-M). The intent and awareness of the parties regarding the factual determination that Mrs. Heber was to receive a life estate in one-half of the Fullerton Properties is set forth in the testimony of the parties themselves. Miss Yaeger clearly stated that this result was intended by her for Mrs. Heber's own benefit (Tr. Vol. II, PP. 50, line 16). Counsel for Mrs. Heber in no way sought to contradict or challenge this intent of Miss Yaeger by either cross-examination or other evidence. In Mrs. Heber's own testimony regarding both the circumstance surrounding the execution of the August 10, 1944 agreement (Tr. Vol. II, PP. 79) and reporting of the income from said properties (Tr. Vol. II, PP. 81 and 82), it is apparent that she accepted the life estate result herself without question. Suffice to say, Mrs. Heber's only objection even now to this factual result is that it imposes a tax burden upon her which none of the parties either discussed, consider or even anticipated at the time the crucial agreement was executed.

The Respondent submits that these Findings of Fact were clearly supported by the evidence and cannot now be set aside under Rule 52(a) of the Rules of Civil Procedure. Also, see Wellington v. Commissioner, 196 F.2d 421 (C.A. 7th, 1952) and Omaha National Bank v. Commissioner, 183 F.2d 899 (C.A. 8th, 1950). Mrs. Heber has in no way offered to

show that they were clearly erroneous as required under Rule 52(a), <u>supra.</u>

B. The Tax Court's Conclusion from the Facts Regarding the Determination that Mrs. Heber Owned a Life Estate in One-half of the Fullerton Properties is Consistent with a Prior California Court's Determination of the Same Issue

The Tax Court in both its Findings of Fact (Tr. Vol. PP. 10) and Opinion (Tr. Vol. I, PP. 20), cited the decis of the California court in <u>Steeve</u> v. <u>Yaeger,</u> 145 Cal. App 704 (1956). Further, the parties themselves stipulated s decision into evidence (Tr. Vol. I, PP. 46). It was in t case that Mrs. Heber sought redress from Miss Yaeger for failing to pay over the income due Mrs. Heber as a life estate tenant in one-half of the income from the Fullerto Properties. Actually, Mrs. Heber there sought a complete rescission, reformation, declaratory relief and action fo quiet title. The Court found that from all of the facts submitted regarding the Agreement of August 10, 1944, its execution and the parties' intent regarding it, that Mrs. Heber had an absolute and unfettered right to an undivid one-half interest in the Fullerton Properties for the per of her natural life, subsequent to the date of said agre The Court considered the circumstances carefully, includ the alleged domination of Miss Yaeger over Mrs. Heber, th fact that the documents were drawn by an attorney who allegedly was Miss Yaeger's, and that the parties were in fact dissolving their partnership. From proof submitted

the Court found (page 462 of that reported opinion) that the parties without doubt each understood and clearly intended that Mrs. Heber's interest thereafter would be that of a life estate in one-half of the Fullerton Properties. The Court further stated thereafter that this was true regardless of the precise words used because (citing the Estate of Franc 190 Cal. 28, 210 P. 417), if there is an unqualified disposition of the rents, issues and profits of a fund or property, real or personal, this is a disposition of the fund or property itself. Further, the Court cited the further provisions of Mrs. Heber's interest in that the Agreement of Aug 10, 1944, provided that the cash income would be maximized by the sale of unproductive income parcels, applying the proceeds to reducing the encumbrances on the remaining parcel so as to thereby increase the cash flow income from the incom producing parcels for distribution in part to Mrs. Heber; no further encumbrances could be incurred without Mrs. Heber's approval; and that in the event of illness, etc., where the income was not sufficient, the property values could be invaded (by way of Sale) for the benefit of either party.

In effect, the holding of the California court was that in construing the agreement of August 10, 1944, Mrs. Heber received an interest in the property itself, namely a life estate. This type of interest is clearly recognized under California law as an interest in real property under Civil Code Section 761.

Certainly such a determination of property interests by

a state court having jurisdiction over the property and t parties, and where each party has had adequate and full opportunity to be heard on the precise issue to be determ Mrs. Heber's attempts to now relitigate these property interests should not now be considered by this court. Se Commissioner v. Summen, 333 U.S. 591.

C. The Decision of the California Court Regarc Mrs. Heber's Interest in the Fullerton Properties as Being a Life Estate Must be Foll by the Tax Court

Although Judge Fay in his Tax Court opinion did not expressly follow or adopt conclusively the California cou decision in Steeve v. Yaeger, supra, it is submitted that was conclusive as to the determination that Mrs. Heber di in fact possess a life estate interest in the Fullerton] ties.

The conclusiveness of state court adjudications reg property rights and interests in a long established prin as set forth in Freuler v. Helvering, 291 U.S. 35 (1934) Blair v. Commissioner, 300 U.S. 5 (1937). Each of these set forth that if taxability flowed from ownership of pr interests, determination of those property rights and in by a state court must be followed in any subsequent tax l gation. Of course, pursuant to the dicta in these cases subsequent cases, such as Gallagher v. Smith, 223 F.2d 28 (3rd Cir. 1955), if it can be shown that the state court p ceeding was "collusive" or not an adversary contest, the Commissioner of Internal Revenue should not necessarily e

bound by it.

The Respondent here, Miss Yaeger, submits that no facts were submitted or even suggested that the purpose of either the Agreement of August 10, 1944, or the resulting litigatio between Heber and Yaeger, had any tax motives. Certainly the issue of the property interests thereby determined were not prompted by either party's intent to shift a tax burden to the detriment of the Commissioner. In fact, the Commissi has taken the position from the first instance of this case that the Government is essentially neutral as to the identit of who is taxable for the income from the Fullerton Properti Also, it is certainly a fair statement that the litigation i Steeve v. Yaeger, supra, was certainly not "collusive" or lacking in adversary qualities.

For this reason, the Respondent further submits that the Tax Court was clearly bound to recognize the California court's determination that Mrs. Heber owned a life estate in the Fullerton Properties under the principle of the cases cited.

D. The Tax Incidence from Rental Income Must be Borne by the Person Owning the Interest in the Property and who is Thereby Entitled to Receive Those Rents

The Tax Court having found that Mrs. Heber was the owner of an undivided one-half life estate in the Fullerton Properties, concluded that the taxability of the rentals received from those properties was taxable one-half to Mrs. Heber and one-half to Miss Yaeger. As authority for such a

result, the Tax Court cited Rev. Rul. 56-221, C.B. 1956-1 58 (Tr. Vol. I., PP. 70) where the Commissioner ruled tha where a mother and two children, who each held an undivid one-third interest in the fee simple interest of a proper rearranged their interests by deed so that the mother own a life estate in the property, the mother was taxable on all of the gross rents from the property during the perio her life estate.

As set forth in the Government's brief to this court (Gov. Br. 21 and 22), there is no question that income fr rents is included in gross income of a taxpayer under Sec 61(a) of the Internal Revenue Code. Further, the Governm sets forth ample authority that co-tenancy interests in p are taxable for their respective proportions of the incom derived from the property. The character of the income i determined by the property interest involved and the inco is then taxed to the owner of the property interest.

As the Respondent has urged above, the Tax Court wa bound to recognize the life estate interest of Mrs. Hebe as determined in Steeve v. Yaeger, supra. The Responden urges further that the Tax Court correctly applied the r of law that the incidence of tax on the Fullerton Proper income should follow ownership of the property interest. shift the tax incidence to another party, i.e., Yaeger h requires that the Tax Court accept the state court's det tion of property interests but refuse to accept the gene

tax consequences dictated from those property interests.

Refusing the state court's determination can be justifie if the State law determinations lead to results contrary to express or implied intent of the Internal Revenue Code. Naturally, the federal income tax law must be consistently applied to all citizens and this determination must be made by the Federal Court--not dictated to it by the State Courts. Regardless of the inconsistencies thereby created in the federal law application to citizens of the various states, for example, in Lyeth v. Hoey, 305 U.S. 188 (1938), the court refused to apply a federal tax statute strictly within the terms of the state court's language and characterization describing an heir's acquisition of property as "by inheritan Other interpretations were possible and the Federal Court sought to resolve the fact situation and interpret the law of taxation "so as to give a uniform application to a nation-wide scheme of taxation".

The Respondent submits that no such justification appear in this case. The life estate of Mrs. Heber as found by the California court in Steeve v. Yaeger, supra, did not depend on any special characteristics of the California law. Certai the general application Section 61 of the Internal Revenue Co and related authority would be universal to life estate interests created under the laws of any state.

Another justification for refusing to follow tax results flowing from state court determinations of property rights is where to do so violates a basic principle of tax law that

substance should control over form. Probably most of the contentions set forth by Mrs. Heber in her brief here on appeal can be grouped in this category. The basis of eac contention is essentially that although Mrs. Heber may ha received a life estate in form, it is not a life estate i substance but something else.

Mrs. Heber, of course, makes such contentions to sup her interpretation of the agreement of August 10, 1944, a resulting position that she sold a capital asset in 1944. such she is now merely receiving payment for said sale an does not in fact own an interest in the Fullerton Propert To-wit: Mrs. Heber's arguments that the receipts of mone by her are analogous to an involuntary conversion (H. Br. p. 15); to an annuity (H. Br., p. 16); to a trust (H. Br. p. 20).

Although not specifically raised here by Mrs. Heber the above contentions are similar to the argument that M Heber was merely entitled to receive payment from Miss Y out of the net rental received from the Fullerton Proper As the Tax Court indicated itself (tr. Vol. I, PP. 21, f note 6), such a theory would negate the tax consequences the life estate to Mrs. Heber, but the facts as determin by both the Tax Court and the California Court in Steeve Yaeger, supra, would not support such a result.

A similar question is posed where a party seeks to h the tax burden of rental income to another party. In Bi v. Bowers, 22 F 2d 450 (D.C.N.Y., 1927), the court held

grantor of an interest in the "net rentals" of property remained taxable on the income because the actual control of the properties was completely retained by the grantor. Although the court acknowledged the form used evidenced a life estate, it was convinced that in substance the ownership control, responsibilities and risks were still entirely with the grantor and that the grantor had in fact assigned his income only rather than transfer the property interest from which the income derived.

The Respondent here urges that Mrs. Heber did in fact receive and still holds an undivided one-half life estate in the Fullerton Properties which was not only created in the proper form but is also valid in substance. The Agreement of August 10, 1944, created separate but equal life estates to one-half of the Fullerton Properties. Each life tenant had the right to receive the income after the cash expenses paid directly to earn this income. Each was liable for the debts incurred and neither could encumber the property without the permission of the other. Each had the right to evict tenants for non-payment of rent, collect the rents and in all other ways deal with the property as a co-tenant. The Agreement did not give the power or the right to either party to exclusively manage or control the properties. Miss Yaeger did attempt to assert such a power but Mrs. Heber promptly curtailed this effectively in her state court action. The Court in Steeve v. Yaeger, supra, and the Tax Court below

both have determined that each life tenant was entitled t their respective share of depreciation and that it could be deducted before determining the rental income payable each life tenant. The risks of earning and ultimately receiving this rental income were to be borne equally by parties during the natural life of Mrs. Heber.

For these reasons, the Respondent, Miss Yaeger, subm that one-half of the income from the Fullerton Properties taxable to Mrs. Heber and cannot under any theory be taxe to Miss Yaeger, who did not own, control or otherwise hav any right to that income or the property interest from wh it generated. The result is exactly the same whether Mrs Heber sold her partnership interest in 1944, exchanged i a "different bundle of rights" as contended by Mrs. Hebe (H. Br., p. 11), or merely received her property interes as a distribution of the partnership assets.

II

THE TAX COURT IN ITS OPINION AND DECISION SHOULD HAVE ALLOWED THE DEDUCTIONS TO MISS YAEGER IN 1955 AND 1957 IN THE AMOUNTS OF $9,086.39 and $3,766.32 RESPECTIVELY, BECAUSE THE DEDUCTIBILITY OF THESE AMOUNTS WAS IN LAW DETERMINED BY THE TAX COURT'S DETERMINATION THAT MRS. HEBER OWNED A ONE-HALF LIFE ESTATE INTEREST IN THE FULLERTON PROPERTIES AND THE INCOME EARNED FROM THOSE PROPERTIES.

The Tax Court in its Opinion (Tr. Vol. I, PP.74) stated that since Yaeger had not argued on brief regarding the Government's disallowance of deductions in the amount of $9,086.39 in 1955 and $3,766.32 in 1957, the court assumed Miss Yaeger had abandoned the deductions.

This was incorrect in that these deductions were not separate issues to be decided but in fact directly related to and part of the basic issue of whether Heber owned a life estate in one-half of the Fullerton Properties.

The deductions were disallowed in the deficiency notices sent to Miss Yaeger and copies of which were set forth and included in Miss Yaeger's Petition to the Tax Court (Tr. Vol. I, PP. 1-14). Specifically, the 1955 deduction in the amount of $9,086.39 was disallowed by the Commissioner as being a capital expenditure although he had previously allowed it in a prior examination (Tr. Vol. I, PP.10). The previous allowance referred to by the Commissioner was a refund claim filed by Miss Yaeger and identified in the Computation of Tax under Rule 50, (Tr. Vol. I, PP.83 and 85).

The 1957 deduction in the amount of $3,766.32 was also disallowed by the Commissioner as being a capital expenditure

(Tr. Vol. I, PP.13). This deduction was not included in the Computation under Rule 50 because Miss Yaeger had cla it on her 1957 tax return directly as a deduction and rec the benefit of it without the necessity of filing a refun claim as had been done in the case of the 1955 deduction the same nature.

To project the true nature of these deductions requi an examination of the Commissioner's own actions with res to them. Pursuant to the California Court decision in St v. Yaeger, supra, Miss Yaeger paid the previously withhe income to Mrs. Heber. These payments were made in 1955 a 1957 as stipulated by the parties hereto (Ex. 14-N, Tr. V I, PP.48) and as found by the Tax Court in its Findings o Fact (Tr. Vol. I, PP.59-60). As there stated the paymen to Mrs. Heber were $27,093.45 of which $9,086.39 was pai in 1955 and the balance of $18,007.06 was paid in 1957.

Naturally, Miss Yaeger was not entitled to deduct te payments to Mrs. Heber per se but if she had previously reported all or a part of them under a claim of right, a thereby paid a tax on said income, she would be entitled t a deduction. Judge Fay in his Opinion for the Tax Court o notice of this possible result in distinguishing the the that Yaeger would be taxable on one-half of the earnings a trustee for Heber (Tr. Vol. I, PP. 73, footnote 9).

After determining the amounts of Heber income actu included in her own prior years' income, Miss Yaeger int a refund claim for the tax year of 1955 in December of 9

based on a recomputation of her 1955 tax liability. Said cleim set forth the results of Steeve v. Yaeger, supra, and included a complete analysis of the income previously report for the tax years 1944 through 1952 by Miss Yaeger including that portion of Heber income reported under claim of right, and the excess thereby determined over that for which she was taxable consistent with the California Court decision. The excess was determined to be $12,852.71 which was examine and allowed in full by the Commissioner. Under Section 1341 of the Internal Revenue Code, the deduction for the payment of this previously reported income to another person can be claimed only in the year of payment by a cash basis taxpayer i.e. Miss Yaeger. Accordingly the Commissioner allowed the deduction of $9,086.39 (the extent of payments made that yea in Miss Yaeger's 1955 refund claim resulting in a refund payment to her in the amount of $4,948.52 on September 17, 1959.

White this refund claim was in process, Miss Yaeger deducted the balance of the deduction on her 1957 tax return to-wit:

Excess income under Section 1341	$12,852
Less claimed deduction on 1955 return by way of refund claim	9,086
Balance to be deducted	$ 3,766

Subsequent to these events, the Commissioner had begun his review of Mrs. Heber's tax returns and found she was not reporting the income from the Fullerton Properties consisten

with the decision in Steeve v. Yaeger, supra. This Audit of Mrs. Heber led to a re-examination of Miss Yaeger's ret and in toto, the case now before this court.

As a result of his audit examinations, the Commission asserted the inconsistent positions whereby he contended t the co-tenants of the Fullerton Properties, Mrs. Heber and Miss Yaeger, were both charged with the one-half of the income determined by the Court in Steeve v. Yaeger, supra belonging to Mrs. Heber. Thus in the deficiency notice to Miss Yaeger for 1955 (Tr. Vol. I, PP.10) and 1957 (Tr. Vol I, PP.13) the Commissioner asserted that she was taxable all of the income from the Fullerton Properties including Mrs. Heber's share. The theory of course was that Miss Yaeger had purchased Mrs. Heber's interest in the propert in 1944 and therefore was the sole owner of the entire pr ties.

To be consistent in his deficiency notice, the Commi then disallowed the previously allowed deduction in 1955 and the deduction taken by Miss Yaeger in 1957 regarding payments to Mrs. Heber as a result of Steeve v. Yaeger, s. Obviously, Miss Yaeger was merely paying for the interest Commissioner was asserting that she owned and therefore s was making a capital expenditure.

Thus, both deductions were denied as a direct and axiomatic result of the issue raised that Miss Yaeger in fact owned the entire Fullerton Properties and Mrs. Heber

not own a life estate in one-half of the income of these properties. They were not separate issues because the Commissioner had already passed on the validity and propriety of the deductions when he granted Miss Yaeger's refund claim in 1959. He raised them later only because these deductions he had approved became inconsistent with his deficiency notice reagrding the ownership of the one-half of the income which the Tax Court has now found is taxable to Mrs. Heber.

For this reason, the Respondent urges now that the decision of the Tax Court be modified to provide that the deductions denied Miss Yaeger in 1955 and 1957 be allowed and the computation under Rule 50 be also accordingly modified. Then the rules of law and the holding of the Tax Court will be consistently and correctly applied to all of the facts and issues in this case.

The Respondent urges this result on appeal here without having previously filed a separate Petition for Review. The Respondent feels that the Commissioner's own Petition for Review has raised the ultimate issue as to who is taxable on the one-half of the income from the Fullerton Properties and as set out above, this issue encompasses and includes the deductions claimed by Miss Yaeger in 1955 and 1957. See Commissioner of Internal Revenue v. Kelly's Estate, 84 F. 2d 958 (C.A.7th, 1936).

CONCLUSION

On the Commissioner's appeal here the opinion of th
Tax Court regarding the determination that Mrs. Heber ow
an undivided one-half life estate interest in the Fuller
Properties and the income derived therefrom should be af
However, the Tax Court's decision should be modified to
Miss Yaeger the deductions in 1955 and 1957 denied to he
the Tax Court's Decision.

Dated: December 30, 1965.

Respectfully submitted

Richard A. Rattray

Richard A. Rattray
Counsel for Respondent Yaege

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

Richard A. Rattray

Richard A. Rattray

Nos. 20085 and 20086

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

v.

LILLIAN E. YAEGER,

Respondent

EMMA M. HEBER AND ESTATE OF HENRY D. HEBER, DECEASED,
EMMA M. HEBER, ADMINISTRIX,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT

OF THE UNITED STATES

BRIEF FOR THE COMMISSIONER

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I N D E X

CITATIONS

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OPINION BELOW

The memorandum findings of fact and conclusions of law of the Tax urt (I-R. 50-74) are not officially reported.

JURISDICTION

The petition for review filed by Mrs. Heber 1/ involves federal

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/ The Estate of Henry D. Heber is a petitioner solely because Mr. ber filed joint returns for the taxable years with his wife, Emma Heber.

income taxes for the years 1956, 1957, and 1958 in the amounts of $291.24, $7,797.50 and $741.56, respectively. (I-R. 96, 104-107.) The Hebers filed joint income tax returns for the taxable years with the District Director of Internal Revenue for the District of Los Angeles, California.

On August 29, 1962, the Commissioner mailed a notice of deficiency to the Hebers for 1956, 1957, and 1958 asserting deficiencies in the respective amounts of $1,273.89, $7,163.57, and $304.66. (I-R. 24-29.) Within ninety days thereafter, on November 27, 1962, the Hebers filed a petition with the Tax Court for a redetermination of the deficiencies under the provisions of Section 6213(a) of the Internal Revenue Code of 1954. (I-R. 20-29.) The decision of the Tax Court was entered December 2, 1964. (I-R. 96.) The case is brought to this Court by a petition for review filed on March 1, 1965, within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. (I-R. 104-107.)

The Commissioner's protective petition for review involves federal income taxes of Lillian Yaeger for 1955 through 1958 in the respective amounts of $4,437.93, $59.12, $1,389.78, and $15.40. (I-R. 87, 97-100.) Miss Yaeger's income tax returns for the taxable years were filed with the District Director of Internal Revenue for the District of Los Angeles, California. On August 29, 1962, the Commissioner mailed notices of deficiency to her for the taxable years 1955 through 1958 asserting deficiencies in the respective amounts of $7,248.54, $2,753.21, $2,929.99 and $1,177.30. (I-R. 9-14.)

thin ninety days thereafter, on November 23, 1962, Miss Yaeger filed a tition with the Tax Court for a redetermination of the deficiencies der the provisions of Section 6213(a) of the Internal Revenue Code of 54, within the three-month period prescribed in Section 7483 of the ternal Revenue Code of 1954. (I-R. 1-14.) The decision of the Tax urt was entered on December 2, 1964. (I-R. 87.) The case is brought this Court by a protective petition for review filed on February 19, 65, within the three-month period prescribed in Section 7483 of the ternal Revenue Code of 1954. (I-R. 97-100.)

Jurisdiction in both appeals is conferred upon this Court by ction 7482 of the Internal Revenue Code of 1954. By order of this urt dated May 17, 1965, the Heber and Yaeger cases were consolidated r briefing, argument, and decision. (I-R. 135-137.)

QUESTIONS PRESENTED

Where Mrs. Heber and Miss Yaeger had been partners in the owner-ip of certain real property and in 1944 executed an agreement rminating the partnership and dividing the properties, with Mrs. Heber ceiving a vested interest of a life estate in an undivided one-half the properties, as determined by the California state court,

1. Is Mrs. Heber taxable on her share of the rental income from e properties, which she received in 1956 through 1958, as ordinary come, as the Tax Court held, or at capital gains rates, as Mrs. ber contends?

2. In the event this Court should reverse the Tax Court on s. Heber's appeal, did Miss Yaeger actually own the entire amount the net rental income earned by the former partnership properties, cluding the portion she transmitted to Mrs. Heber, so as to be xable on all of it as ordinary income during the taxable years?

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) General Definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

*   *   *

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

*   *   *

(5) Rents;

*   *   *

(13) Distributive share of partnership gross income;

*   *   *

(26 U.S.C. 1958 ed., Sec. 61.)

SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

For purposes of this subtitle--

*   *   *

(3) Long-term capital gain.--The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income.

*   *   *

(26 U.S.C. 1958 ed., Sec. 1222.)

STATEMENT

The facts as stipulated by the parties (I-R. 44-49) and as found by the Tax Court (I-R. 51-65) may be summarized as follows:

Mrs. Heber and Miss Yaeger had been friends and companions since 1928. ring the year 1935, and for a number of years thereafter, they resided gether in Fullerton, California. Mrs. Heber has been a registered nurse nce 1927. Miss Yaeger has been a real estate broker for over 50 years. -R. 52.)

On September 2, 1939, Mrs. Heber entered into a partnership agree- nt with Miss Yaeger under the terms of which they acknowledged that ey were the equal owners of certain properties described therein as rcels 1 and 2; that they intended to acquire additional properties in ich they were to have an equal interest; that they were to own and erate these and other properties as equal partners; that should ther partner become dissatisfied, or desire to withdraw, such rtner should not be permitted to do so before making a proposal ther to sell or purchase the undivided one-half interest in the fee nership of properties owned by the other party; and that in the ent no sale occurred within a period of thirty days, the partnership s to be dissolved by operation of law. In the event of a dissolu- on of the partnership, the properties or the proceeds thereof were be divided equally between Mrs. Heber and Miss Yaeger. (I-R. 52-53.)

Parcels 1 and 2, which were located in Fullerton, California, ntained certain improvements consisting of buildings which produced ntal income. Legal title to Parcels 1 and 2 was held by Security- rst National Bank of Los Angeles as trustee for the partnership. ter the execution of the partnership agreement on September 2, 1939. e partnership acquired a liquor store and additional properties

designated as Parcels 3, 4, 5, and 6, representing vacant lots, title to which was transferred to Miss Yaeger's attorney. In January or February of 1944, the partnership also acquired some property designated as Parcel 7, which contained a number of citrus trees, but was not productive of income. All of the properties of the partnership were managed solely by Miss Yaeger. Mrs. Heber did not participate in their management. (I-R. 53-54.)

On August 10, 1944, Mrs. Heber and Miss Yaeger executed a termination agreement which recited that they had formed a partnership on September 2, 1939, relating to their property holdings and provided in part that (I-R. 54):

> [T]he parties hereto * * * desire to clarify and modify the terms of said documents [the deeds to the various properties and the partnership agreement], as well as convenant and agree by the terms hereof to partition and divide said properties, as hereinbefore set forth.

This termination agreement also provided that Parcels 1 through 6 were to be conveyed to Miss Yaeger, with a life estate in and to one-half of the rents, issues and profits to Parcels 1 through 7 (Parcels 7 having previously vested in Miss Yaeger) being reserved to Mrs. Heber for and during the period of her natural life; that Parcels 3 through 7 should be sold and the proceeds applied toward liquidating existing indebtedness on Parcels 1 and 2; that each party was entitled from September 1, 1944, to a drawing account of at least $100 per month against the net income to which each might be entitled; that if the undivided one-half of the net income should be insufficient to care for either party because of illness, want or other necessity, or to

tain necessary medical or other assistance, so much of the principal or rpus should be used as necessary for such purpose; that any further inbtedness on the properties could be incurred only with the consent of th parties; that accurate books of account were to be kept and audited d that a written account was to be made on December 31st of each year all assets and liabilities, receipts, disbursements, and net profits, th an annual settlement of any profits due. (I-R. 54-56.)

Pursuant to the termination agreement, deeds were executed conining the following language (I-R. 56-57):

(1) With respect to Parcels 1 and 2:

> SECURITY-FIRST NATIONAL BANK * * * does hereby grant to EMMA M. STEEVE [Heber] * * * a life estate consisting of one-half of the net rents, issues and profits for and during the period of her natural life only, and to LILLIAN E. YAEGER * * * the remaining net income, together with title in fee, subject to such life estate, in and to that real property * * *.

(2) With respect to Parcels 3, 4, 5, and 6:

> EMMA M. STEEVE [Heber] * * * does hereby grant to LILLIAN E. YAEGER * * * all that real property situate in the County of Orange, State of California, described as follows [describing Parcels 3, 4, 5, and 6].
>
> EXCEPTING AND RESERVING * * * to the Grantor, for and during the period of her natural life only, an estate consisting of one-half of the rents, issues and profits received or derived therefrom.

(3) With respect to Parcel 7:

> LILLIAN E. YAEGER * * * does hereby grant to EMMA M. STEEVE [Heber] * * * a life estate consisting of one-half of the rents, issues and profits received or derived from all that real property * * *.

ubsequent to August 10, 1944, Parcels 3 through 6 were sold to third arties and the proceeds applied to reduce the indebtedness on arcels 1 and 2. (I-R. 57.)

Parcels 1, 2, and 7 (hereafter sometimes referred to as the Fullerton properties) were retained, and it is the income from these properties that gives rise to the present tax controversy. (I-R. 57.)

The deeds were recorded in accordance with the termination agreement. Thereafter, at all times relevant hereto, Miss Yaeger continued to manage and control the Fullerton properties, taking charge of collecting the rents and paying the property taxes and other expenses of the properties. (I-R. 57.)

Miss Yaeger's purpose in causing Mrs. Heber to execute the termination agreement was to reshuffle their interests in the partnership properties in order to reflect the fact that Mrs. Heber, because of illness, had become unable to assist Miss Yaeger in any of the affairs of the partnership. When Mrs. Heber and Miss Yaeger executed the termination agreement, it was the belief and intention of each of them that the partnership theretofore existing between them was thenceforth terminated. Each of them was aware at that time that Mrs. Heber was receiving thereby a life estate in an undivided one-half of the Fullerton properties and that Miss Yaeger was also receiving, as a tenant in common a life interest in an undivided one-half of the properties, measured by Mrs. Heber's life, plus the entire ownership of the properties upon Mrs. Heber's death. (I-R. 57-58.)

The basic manner in which the former partnership properties were to be operated and maintained was significantly altered as a result of the execution of the termination agreement. Instead of continuing to acquire new properties, it was agreed that certain nonincome-producing properties were to be sold. Pursuant to the terms of the termination

reement, Miss Yaeger used the proceeds from the sales to effect sub-
antial renovations of the Fullerton properties and to reduce the
tstanding indebtedness thereon. Miss Yaeger also used a portion of
e net rentals produced by the properties to effect these ends. (I-R.
.)

After the execution of the termination agreement, Mrs. Heber moved
Los Angeles. Miss Yaeger remitted to Mrs. Heber the $100 per month
provided for in paragraph 6 of the termination agreement until
nuary 1, 1948. Thereafter, Miss Yaeger ceased paying any monies to
s. Heber with respect to her interest in the Fullerton properties,
t began to pay herself $200 per month as a manager's salary, charging
is amount against the rental income produced by the Fullerton
operties. (I-R. 58.)

In January, 1949, Mrs. Heber sought legal counsel pertaining to
r rights under the termination agreement. On August 4, 1949, Mrs.
ber initiated proceedings against Miss Yaeger in the Superior
urt, Orange County, California. Mrs. Heber's complaint set up
parate causes of action for rescission of the termination agreement,
formation, declaratory relief, and to quiet title. That court in an
reported opinion found, among other things, that Mrs. Heber was, by
rtue of the termination agreement, vested with a life estate in and
an undivided one-half interest in the Fullerton properties for and
ring her life; that Miss Yaeger, by virtue of the termination agree-
nt, acceded to ownership of the remainder interest in the properties;
at Miss Yaeger had not sold all of the property agreed to be sold

for the purpose of paying off the encumbrances on the Fullerton propertie and that Miss Yaeger had not paid Mrs. Heber her full share of the income from the Fullerton properties. That court, moreover, in approving the report and account prepared by a referee, found in accordance therewith that Miss Yaeger had collected, as rents and income from the Fullerton properties, during the period in question, namely, from August 10, 1944, through December 31, 1952, the total sum of $167,998.18; that she had expended $101,926.50 for maintenance of the property, leaving a net income of $66,071.68, of which Mrs. Heber was entitled to one-half, or $33,035.84; and that Miss Yaeger had paid Mrs. Heber only $5,942.39, leaving a balance of $27,093.45 owed to her. The court held that in the determination of Mrs. Heber's share of the net income from the Fullerton properties, Miss Yaeger was not entitled to deduct depreciation on the properties. A final judgment was entered in accordance with these findings, and Mrs. Heber was awarded a total of $27,093.45, plus interest from August 10, 1944, through December 31, 1952. On October 26, 1956, this judgment was affirmed on appeal by the District Court of Appeals, Fourth District, California, sub nom. Steeve v. Yaeger, 145 Cal. App. 2d 455, 302 P. 2d 704 (1956). (I-R. 58-60.)

Miss Yaeger paid the amounts awarded to Mrs. Heber pursuant to this judgment, as follows (I-R. 60):

Year Paid		Payments on Judgment	Interest
1955		$ 9,086.39	--
1957		18,007.06	$5,509.30
	Total	$27,093.45	$5,509.30

During the years 1953 through 1955, the Fullerton properties had net ıcome, adjusted in accordance with the decision in Steeve v. Yaeger, in ıe total amount of $31,956.76. In accordance with the principles set ›rth in that decision, Mrs. Heber's share thereof was $15,978.38. Payınts to Mrs. Heber of her share of the net income from the Fullerton ›operties allocable to the years 1953, 1954, and 1955 were made as ›llows (I-R. 60):

Year Paid	Amount
1954	$ 1,200.00
1955	1,100.00
1956	5,536.30
1957	8,142.08
1958	- -
Total	$15,978.38

The following table shows the net income of the Fullerton ›operties in 1956 through 1958, and amounts received by Mrs. Heber [-R. 61):

	Net income from Fullerton Properties	Share of net income allocated on books to Mrs. Heber	Amount of net income actually received by Mrs. Heber	Total amount received by Mrs. Heber from Fullerton Properties
956	$ 8,697.33	$ 4,348.67	$ 1,200.00	$ 6,736.30
957	10,063.55	5,031.78	4,348.67	36,805.17
958	8,814.03	4,407.02	5,031.78	5,031.78
	$27,574.91	$13,787.47	$10,580.45	$48,573.25

During the taxable year 1956, Mrs. Heber reported the receipt of rdinary income in the amount of $4,547.27 from the Fullerton properties. ıe Commissioner determined that Mrs. Heber during 1956 had received rdinary income from the Fullerton properties in the aggregate amount of),884.96 and increased her taxable income that year by $5,337.69. [-R. 62.)

In her income tax return for 1957, Mrs. Heber reported the receipt from the Fullerton properties of $5,840.38 and claimed that of that amount $3,929.08 represented gain arising from the sale of a capital asset held for more than six months. Prior to 1957, Mrs. Heber had reported all money received by her with respect to her interest in the Fullerton properties as ordinary income. In 1957, after receiving payment of some $36,805 in respect of her interest in the Fullerton properties, Mrs. Heber was advised by her accountant to treat all amounts received by her from the properties as proceeds from the sale or exchange of a capital asset held in excess of six months. The capital gain of $3,929.08 reported in Mrs. Heber's 1957 income tax return attributed to the Fullerton properties, was determined by her accountant pursuant to a "RECOMPUTATION OF [HER] FEDERAL INCOME TAX FOR [THE] YEARS 1945 THROUGH 1956 INCLUSIVE." The accountant "recomputed" Mrs. Heber's income tax for those years (1) by deducting from her gross income as reported for each year the amount of income received by her from the Fullerton properties during such year and (2) by adding thereto an amount labeled "Capital Gain Resulting from Sale of Fullerton Properties." There is nothing in the record to indicate the ground upon which Mrs. Heber's accountant proceeded to recompute her net or taxable income during such years. (I-R. 62-63.)

The Commissioner increased Mrs. Heber's taxable income for the year 1957 as follows (I-R. 63):

Taxable income as disclosed by original return		$ 7,921.53
Additional income and unallowable deductions:		
(a) Interest income	$ 5,509.30	
(b) Judgment income	14,166.90	
(c) Ordinary income-Fullerton properties	5,031.77	24,707.97
Total		$32,629.50
Nontaxable income and additional deductions:		
(d) Capital gain	2,258.54	
(e) Exemption	600.00	2,858.54
Taxable income as corrected		$29,770.96

The Commissioner explained these adjustments by stating in part, at Mrs. Heber had failed to report interest income in the amount of ,509.30; that (I-R. 63)--

> the net amount of $14,166.90 received by you from a judgment in 1957 constitutes taxable income for 1957 * * * that you are not entitled to compute the tax on such income under the provisions of sections 1301-1307 of the Internal Revenue Code of 1954

d that she received as ordinary income $5,031.77 as opposed to the ,929.08 reported by her as long-term capital gain from the Fullerton operties. (I-R. 63.)

Mrs. Heber's income tax return for 1958 showed that she received ,031.78 from the Fullerton properties. Of that amount, $3,923.50 s reported as long-term capital gain. The Commissioner determined at "such gain is taxable as ordinary income in the amount of ,298.74" and increased Mrs. Heber's taxable income by that amount. -R. 64.)

The Tax Court held (I-R. 65-74) that, since Mrs. Heber prepared r returns on the cash method of accounting, she was taxable only

upon receipt of amounts paid to her in respect to her life estate in the Fullerton properties, and that she was entitled to depreciation. Therefore, amounts received in the years 1956 through 1958 representing payments from the Fullerton properties for the years after December 31, 1952, were adjusted to decrease 1956 taxable income by $3,243.05, and to increase taxable income for 1957 and 1958 by $8,149.46 and $1,663.76, respectively. (I-R. 71, 90, 96.) The Tax Court also held that the tax attributable to the receipt of damages as a result of the decision in Steeve v. Yaeger, supra, might not exceed the aggregate of the increases in her taxes for the years 1948 through 1952 had the allocable portions been included in her gross income for such years pursuant to Section 1305 of the Internal Revenue Code of 1954. Consequently, 1957 income tax was increased by $1,915.68. (I-R. 71-72, 90.)

With respect to Miss Yaeger, the Commissioner's statutory notice of deficiency increased her taxable income for the year 1955 by $7,207.88. He explained this action by stating (I-R. 64):

> (a) It is determined that your income from the "Fullerton Properties" totaled $11,990.62 instead of the $4,782.74 reported on your income tax return for 1955.

The Commissioner also decreased Miss Yaeger's taxable income by the $2,400 management fee which the court in Steeve v. Yaeger, supra, ruled should be returned to the net income of the Fullerton properties. The Commissioner increased Miss Yaeger's taxable income for the years 1956 through 1958 by determining that the entire net income of the Fullerton properties during each of these years, rather than one-half of the net income as reported by Miss Yaeger, should be included in

r taxable income. (I-R. 64.) The Commissioner further determined in e deficiency notice that Miss Yaeger was not entitled to deductions the respective amounts of \$9,086.39 and \$3,766.32 during 1955 and 57 as a result of payments on the judgment awarded Mrs. Heber in the cision Steeve v. Yaeger, supra. (I-R. 64-65.)

The Tax Court held (I-R. 74) that Miss Yaeger was taxable in the ars 1955 through 1958 on only half the net rental income from the llerton properties as ordinary income.[2/] To protect the revenue, e Commissioner has filed a petition for review against Miss Yaeger -R. 97-100), contending in the alternative that all the income om the properties was taxable to her, so that in the event this urt should reverse the Tax Court and should hold that Mrs. Heber not taxable on amounts she received from the properties, such ounts would be taxable to Miss Yaeger.

SPECIFICATION OF ERRORS RELIED UPON BY THE COMMISSIONER

In the event this Court should reverse the Tax Court and ould hold that Mrs. Heber and Miss Yaeger during the taxable years 55 through 1958 did not each own a one-half interest in the net come produced by the Fullerton properties, and, therefore, that s. Heber is not taxable on payments she received in those years om Miss Yaeger under the termination agreement of August 10, 1944, her share of such rental income, then the Tax Court should also reversed with respect to Miss Yaeger, and the entire amount of the ntal income should be held to be taxable income to Miss Yaeger ring the years involved.

/ The Tax Court also sustained (I-R. 74) the Commissioner's disal- wance of deductions in 1955 and 1957 which are not here involved.

SUMMARY OF ARGUMENT

1. Mrs. Heber's share of rental income from the Fullerton properties, which she received in 1956 through 1958, is taxable as ordinary income rather than as capital gain. The Tax Court correctly held that even if the termination agreement effected a sale of Mrs. Heber's partnership interest, her share of the rental income from the properties is taxable as ordinary income. If Mrs. Heber sold her partnership interest, what she received for that interest was a life estate in one-half of the Fullerton properties, as the California state court decision involving the taxpayers here so holds. This decision is controlling as to the nature of Mrs. Heber's property interest. If there was a sale or exchange in 1944, Mrs. Heber had gain or loss in that year in the amount of the difference between the value of the life estate she received and the value of the partnership interest she gave up; but regardless of whether she had gain or loss in 1944, the fact remains that she received a life estate from which she realized income in the taxable years 1956 through 1958, in the form of rent which is taxable as ordinary income rather than as capital gain. Under Section 61(a) of the 1954 Code, taxable income includes all gains, from whatever source derived, including rents. What Mrs. Heber received was her share of the rents, issues and profits from her ownership interest, taxable as ordinary income and not as capital gain.

The capital gains provisions are narrowly construed, and where Mrs. Heber retained the normal incidents of ownership, without any shift of economic benefit or control of the property, capital gains

eatment should be denied. The capital gains provisions do not warrant tending capital gains treatment to annual receipts derived from a ntinuing risk-bearing participation in the future income of an asset.

No concession of Government counsel required the Tax Court to termine whether there was a sale of Mrs. Heber's partnership interest. nce Mrs. Heber's receipt of a life estate is acknowledged and must be cepted in view of the California court's decision, there was no cessity for the Tax Court to determine whether the 1944 agreement sulted in a sale of her partnership interest. Moreover, it is well ttled that the parties to a case may not stipulate an issue of law, d when they undertake to do so such stipulation is not binding upon e court, for the legal effect of a transaction is a question of law. prevent injustice, a federal court may disregard and set aside a ipulation which has been inadvertently entered into by Government unsel.

There was no sale of a capital asset. The record shows that there re no negotiations for sale such as normally accompany the sale of operty; there is no language in the termination agreement consonant th a sale or exchange; provisions in the termination agreement incate that the parties intended, as the California state court asonably concluded, that Mrs. Heber should have a vested interest the properties themselves, not merely the right to income. Thus, e agreement provided that both parties should agree with respect contracting any indebtedness; that both dispose of all properties cept Parcels 1 and 2; and that each had the right to invade the

corpus of the properties if the net income should be insufficient to care for them in the event of illness, want, or other necessity. Mrs. Heber's understanding of her property interest is shown by the fact that she reported the net income from the properties as ordinary income until 1957. The parties simply changed the nature of their ownership interests in the Fullerton properties and Mrs. Heber continued to be entitled to one-half of the rent income during her lifetime. In contrast to the usual sale, there was no fixed amount stated as the "purchase price", no assets were pledged for its payment, Miss Yaeger was not personally liable, no down payment was made, and no other assets were pledged or guaranty given. Mrs. Heber bears the risk of whether the properties will prove productive in the future.

2. In the alternative, if this Court reverses the Tax Court on Mrs. Heber's appeal, the Tax Court should also be reversed on the Commissioner's appeal against Miss Yaeger. In that event, it is urged that one-half the net rental income held by the Tax Court to be taxable to Mrs. Heber as ordinary income actually belongs to Miss Yaeger and was paid to Mrs. Heber as purchase money. Thus it should be taxed to Miss Yaeger as ordinary income (rent), with the result that she, as the sole owner of the Fullerton properties, is taxable on the entire income from them.

ARGUMENT

I

MRS. HEBER'S SHARE OF RENTAL INCOME FROM THE FULLERTON PROPERTIES, RECEIVED IN 1956 THROUGH 1958, IS TAXABLE AS ORDINARY INCOME RATHER THAN AS CAPITAL GAIN

The sole issue on these appeals is as to how that portion of rental
come from the Fullerton properties which was paid over to Mrs. Heber
the taxable years (1956 through 1958) should be treated. Mrs. Heber
ntends (Br. 8-27) that the termination agreement of August 10, 1944,
ecuted by her and Miss Yaeger (Ex. 9-I, I-R. 118-126) resulted in
ther a purchase or exchange of Mrs. Heber's partnership interest,
ich was a capital asset, and that under Section 1201 of the Internal
venue Code of 1954, she is entitled to report what she received as
pital gain. However, the Tax Court sustained the Commissioner's
termination that the amounts paid to Mrs. Heber were taxable as
dinary income rather than as capital gain. Decision was based upon
) approval and acceptance of the holding in Steeve [Heber] v. Yaeger,
5 Cal. App. 2d 455, 302 P. 2d 704 (I-R. 46), that under the termina-
on agreement of 1944 Mrs. Heber received a life estate in an undivided
e-half of the Fullerton properties and (2) a holding that it was
material whether or not Mrs. Heber had sold her former partnership
terest to Miss Yaeger in return for this life estate, since the
come from the Fullerton properties she received would in any event
taxable to her as ordinary income. We submit that the Tax Court
s correct and, accordingly, that there is no merit to Mrs. Heber's
ntention.

A. The Tax Court correctly held that, even if the termination agreement effected a sale of Mrs. Heber's partnership interest, her share of the rental income from the properties is taxable as ordinary income

One of Mrs. Heber's principal contentions (See Br. 22) is that the
ax Court erred in not determining whether the August 10, 1944,

termination agreement resulted in a sale or exchange of her partnership interest for a life estate in one-half of the Fullerton properties. But it was plainly unnecessary for the Tax Court to make such a determination. As that court said (fn. 7, R. 71), the only questions which would be resolved by such a determination are (1) whether Mrs. Heber had gain or loss in 1944 upon her receipt of the life estate and (2) the correct bases of Mrs. Heber and Miss Yaeger in the respective assets--questions which are not presented in this case.

Assuming that Mrs. Heber sold or exchanged her partnership interest, what she received for that interest was a life estate in one-half of the Fullerton properties. This is indisputable in view of the state court decision in Steeve v. Yaeger, supra, which is controlling as to the nature of Mrs. Heber's property interest.[3/] If there was a sale or exchange in 1944, Mrs. Heber had gain or loss in 1944 in the amount of the difference between (1) the value of the life estate she received and (2) the value of the partnership interest she gave up.[4/] But we are not concerned here with Mrs. Heber's liability for tax in 1944. And, regardless of whether she had gain or loss in 1944, the

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3/ See Commissioner v. Sunnen, 333 U.S. 591, 598; Morgan v. Commissioner, 309 U.S. 78, 80, rehearing denied, 309 U.S. 626; Commissioner v. Siegel, 250 F. 2d 339 (C.A. 9th); Goold v. Commissioner, 182 F. 2d 573 (C.A. 9th).

4/ Capital gain is "gain from the sale or exchange of a capital asset" Section 1222(3) of the 1954 Code, supra); the "gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis" (Section 1001(a)); and the "amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received" (Section 1001(b)). Since a life estate is "property (other than money)," it is only the "fair market value" of the life estate that enters into the computation of capital gain.

:t remains that she received a life estate from which she realized :ome in the taxable years involved here (1956 through 1958) in the :m of rent, which is taxable as ordinary income rather than as capital in.

If Mrs. Heber is arguing that the life estate and the income from should be treated as one and the same thing, there is no merit in argument. The rental payments to Mrs. Heber, being rent, were linary income unless they constituted a part of the sales price of r partnership interest. But they obviously did not (assuming there s a sale). What she received for her partnership interest was roperty" consisting of a life estate in one-half of the Fullerton operties, not the cash payments of rent which were made to her. The nt was income from her property interest, the life estate, not a yment made to her by Miss Yaeger.

Section 61(a) of the Internal Revenue Code of 1954, supra, provides at taxable income includes all gains from whatever source derived cluding rents. Section 1.61-8 of Treasury Regulations on Income Tax 954 Code) provides that gross income includes rentals received or crued for the occupancy of real estate or the use of personal operty. Under the facts presented here, what Mrs. Heber received s her share of the rents, issues and profits from her ownership terest, taxable as ordinary income, and not as capital gain. See st v. Commissioner, 155 F. 2d 121, 157 F. 2d 331 (C.A. 9th). Indeed, s. Heber continued to receive the same share of proceeds from the llerton properties after the agreement that she had before. Income

is taxable to the one who earns it, or the one who owns the property which gives rise to the income. Lucas v. Earl, 281 U.S. 111. Joint tenancy and tenancy in common both consist of undivided interests in property, and the net income from property so held is generally taxable in proportion to shares of ownership in the property. I.T. 2082, III-2 Cum. Bull. 176 (1924).

The capital gains provisions have always been narrowly construed to protect the revenue and to deny the preferential lower rates to taxpayers attempting to cloak ordinary business income as the proceeds of the sale of a capital asset. Corn Products Co. v. Commissioner, 350 U.S. 46, 52; Hort v. Commissioner, 313 U.S. 28, 31. Here there was neither form nor substance of a sale. Mrs. Heber retained the normal incidents of ownership, without any shift of economic benefit or control of the property purportedly transferred. Transactions "which do not vary control or change the flow of economic benefits, are to be dismissed from consideration." Higgins v. Smith, 308 U.S. 473, 476. It is clear that Congress never intended to accord capital gains treatment to anything more than a realization upon the present value of an asset at the time of its transfer, and that any application of the provisions that permits the fruits of a continued sharing in the future gains and profits produced by the asset to be taxed only as capital gains would be basically offensive to the purposes of the capital gains provisions. Thus the reason given for the special tax treatment first accorded to capital gains by the Revenue Act of 1921 was that (H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10-11 (1939-1 Cum Bull. (Part 2) 168, 176)):

> The sale of farms, mineral properties, and other capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum * * * in the year in which the profit is realized.

e only thing that was intended to be given proferential treatment was e realization, by a sale, of "gains and profits earned over a series years" in the past and thus reflected in the present value of the set at the time of the sale.

The same limitation is implicit in the requirement of the statute at, for capital gains treatment the asset must have been held for a ated period (now six months) prior to its "sale," a requirement that kes sense only if the gain realized and accorded capital gains treat- nt represents values that accrued during that period--i.e., up to, t not after the date of the sale.

The conclusion is equally dictated by the Supreme Court's repeated cognition that the purpose of the capital gains provisions was to ford relief from the application of the steeply progressive ordinary tes to the realization in a single year of values that may have crued over many years in the past. Commissioner v. Gillette Motor ., 364 U.S. 130, 134; Commissioner v. P. G. Lake, Inc., 356 U.S. 0, 265; Burnet v. Harmel, 287 U.S. 103. That purpose obviously es not warrant extending capital gains treatment to annual receipts rived from a continuing risk-bearing participation in the future come from the asset.

The case of Commissioner v. Peterman, 118 F. 2d 973 (C.A. 9th), volving an involuntary tax sale of realty, contrary to the taxpayer's

contention (Br. 16) is in no way analogous. The other cases relied upon by the taxpayer (Br. 22, 25-26) are also inapposite. Those cases--United States v. Adamson, 161 F. 2d 942 (C.A. 9th); McAllister v. Commissioner, 157 F. 2d 235 (C.A. 2d); Bell's Estate v. Commissioner, 137 F. 2d 454 (C.A. 8th), and Estate of Camden v. Commissioner, 139 F. 2d 267 (C.A. 6th)--deal with gain from the sale of capital assets, not the treatment of income derived from such assets.

B. The Tax Court was not required to determine whether there was a sale of Mrs. Heber's partnership interest

Mrs. Heber asserts (Br. 11-12, 23-24) that the Tax Court incorrectly ignored a so-called "stipulation" by Government counsel and decided the case on an "irrelevant theory of its own" (Br. 11). The fact is that Government counsel conceded (II-R. 14) that, if a sale occurred in 1944, "the payments made by Miss Yaeger to Mrs. Heber would simply be consideration for the sale of a capital asset, that this would be capital gains, but in that event Miss Yaeger would be taxable on the entire income from the property." Obviously, counsel was referring to a sale by Mrs. Heber of her partnership interest as including her entire interest in the Fullerton properties in consideration of cash payments by Miss Yaeger in the amount of one-half of the rent. The concession does not require a determination as to whether there was a sale by Mrs. Heber when, as is so clearly true, if there was a sale what Mrs. Heber received on the sale was a life estate rather than a right to receive one-half of Miss Yaeger's rental income. Indeed, as the Tax Court noted (I-R. 21, fn. 6), Mrs. Heber makes no

tention that she sold her partnership interest for a promise to pay ercentage of the net profits to her and thus all of the rent belonged Miss Yaeger and was paid to her (Mrs. Heber) only as purchase money. follows that, since the receipt of a life estate is acknowledged-- must in any event be accepted on this record and the California rt's decision--there was no necessity for the Tax Court to determine ther the 1944 termination agreement resulted in a sale of Mrs. er's partnership interest.

Moreover, it is well settled that the parties to a case may not pulate an issue of law, and when they undertake to do so such pulation is not binding upon the court and will be disregarded, ce the legal effect of a transaction is a question of law. Estate Sanford v. Commissioner, 308 U.S. 39, 51, rehearing denied, 308 . 637; Swift & Co. v. Hocking Valley Ry. Co., 243 U.S. 281, 289; Angeles Shipbuilding & Drydock Corp. v. United States, 289 F. 2d , 231 (C.A. 9th); Davis v. Commissioner, 241 F. 2d 701, 703 (C.A.); Daugaard v. Hawkeye Security Insurance Co., 239 F. 2d 351, 354 .A. 8th); Commissioner v. Union Pac. R. Co., 188 F. 2d 950 (C.A. 2d); bb v. Commissioner, 121 F. 2d 1015 (C.A. 5th); London-Butte Gold M. v. Commissioner, 116 F. 2d 478, 479-480 (C.A. 10th).

It is also to be noted that a federal court may disregard and set ide a stipulation which has been inadvertently entered into by vernment counsel. American Food Products Co. v. United States, 73 . Cl. 526; Federal Export Corp. v. United States, 25 F. Supp. 109, 1 (Ct. Cl.), certiorari denied, 308 U.S. 590; Rule 31(b)(5), Rules

of Practice, Tax Court Rules of the United States (Rev. 1958, 1964 ed.). This Court so pointed out in Berry v. Commissioner, 254 F. 2d 471, relied on by Mrs. Heber (Br. 24) and that case was merely remanded for clarification of the stipulation.

The factual situation in Burstein v. United States[5/], 232 F. 2d 19 (C.A. 8th) differs materially from the case now under consideration. The Burstein case related to a stipulation as to essential facts necessary to determine the amount of damages involved in the action, and did not relate, as here, to a legal theory or conclusion to be drawn from the facts.

C. There was no sale of a capital asset

Mrs. Heber's counsel admitted (II-R. 10) that there were no negotiations for sale such as normally accompany the sale of property. There is no language in the termination agreement consonant with a sale or exchange. The preamble of the agreement states (I-R. 121) that the parties desired "to clarify and modify the terms" of the 1939 co-partnership agreement and deeds, and "covenant and agree by the terms hereof to partition and divide said properties". The termination agreement further provided (I-R. 123) that no indebtedness should be contracted on the properties without the concurrence of both parties, that each must sign any document necessary to renew existing indebtedness; that if the net income of the properties should be insufficient to care for both parties in the event of illness, want, or other necessity, either could use so much of the principal or corpus of the properties as necessary for her maintenance and care; that (I-R. 122)

5/ The taxpayer's brief (p. 24) inadvertently cites this case as "Bernstein vs. U. S., 253 F 2d 19 (C.A. Mo. 1956)."

th parties, not Miss Yaeger alone, agreed to dispose of all property the former partnership except Parcels 1 and 2 and to use the proceeds ward payment of the indebtedness on those parcels; and that (I-R. 124) ch party was entitled to a yearly accounting of net profits. The rious transfers necessary to carry out the agreement were by deeds ich were duly recorded. (I-R. 45-46, Exs. 10-J, 11-K, and 13-M.) reover, Mrs. Heber's understanding of her property interest is shown the fact that she reported the net income from the properties as dinary income until 1957. (I-R. 62.) Not to be overlooked, also, the fact that the parties simply changed the nature of their owner-ip interests in the Fullerton properties, albeit in such a way that s. Heber continued to be entitled to one-half of the rent income ring her lifetime.6/

Mrs. Heber's attempt to show that the termination agreement was t a true agreement (Br. 5-6, II-R. 8) is controverted by the refusal the California court to rescind the agreement. Steeve v. Yaeger, pra. As the Tax Court concluded, we must accept the termination reement, as interpreted by the California court, in defining the operty interests of the parties. Commissioner v. Sunnen, 333 U.S. 591;

/ The record shows that in 1939 Mrs. Heber's initial investment in e partnership properties was approximately $4,500 (Ex. 15-Y); that the time of the termination agreement her interest in the net orth of the partnership was approximately $12,450 (Ex. 17); and at she had received approximately $80,000 from her partnership terest from 1944 to 1963 (II-R. 52), approximately $60,000 of ich was in the years 1954 through 1958 (Ex. 14-N). She had re-eived the benefit of a distribution from corpus when she was ill d the income from the properties was insufficient for her case. Steeve v. Yaeger, supra.)

Morgan v. Commissioner, 309 U.S. 78; Commissioner v. Siegel, 250 F. 2d 339 (C.A. 9th); Goold v. Commissioner, 182 F. 2d 573 (C.A. 9th).

In contrast to the instant transaction, the usual sale is a transfer of property in which the transferor completely severs his relationship to the property and receives either full payment in cash, or a promise to pay a fixed amount, secured by the pledging of other assets or the personal liability of a solvent guarantor, or paid by a substantial down payment, with the property itself pledged to secure the payment of the balance of the purchase price. Here no fixed amount was stated as the "purchase price", no assets were pledged for its payment, Miss Yaeger was not personally liable, no down payment was made, and no other assets were pledged or guaranty given. The rents she will receive in the future, are entirely dependent on what income is produced by the properties and she bears the risk of whether the properties will prove productive.

II

IF THIS COURT REVERSES THE TAX COURT ON MRS. HEBER'S APPEAL, THE TAX COURT SHOULD ALSO BE REVERSED ON THE COMMISSIONER'S APPEAL AGAINST MISS YAEGER

The Commissioner determined deficiencies against Miss Yaeger for the years 1955 through 1958 in the total amount of $14,109.04, resulting from issues on appeal and some that are not here involved. (I-R. 9-14.) Under the Tax Court's decision, there are deficiencies for those years of $5,902.23 (I-R. 87) as to which Miss Yaeger has not appealed.

The Commissioner's primary position, set forth in the earlier portions of this brief, is that the Tax Court was correct in taxing

-half the rental income from the Fullerton properties to Mrs. Heber. ever, the Commissioner has filed a petition for review against Miss ger (I-R. 97-100) to protect the revenue and we urge, in the al- native, that the one-half of the net rental income held by the Tax rt to be taxable to Mrs. Heber as ordinary income actually belonged Miss Yaeger and was paid to Mrs. Heber as purchase money. Thus, should be taxed to Miss Yaeger as ordinary income (rent), with result that she, as the sole owner of the Fullerton properties, taxable on the entire income from them.

CONCLUSION

On Mrs. Heber's appeal, the decision of the Tax Court is correct should be affirmed. If this Court reverses the Tax Court on Mrs. er's appeal, the Court should also, on the Commissioner's appeal, verse the Tax Court's decision as to Miss Yaeger. If this Court firms the Tax Court on Mrs. Heber's appeal, the Commissioner's tective petition for review against Miss Yaeger should be dismissed.

Respectfully submitted,

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VEMBER, 1965.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ________________ day of ____________________ 1965.

CAROLYN R. JUST,
Attorney.

No. 20086

(A companion case to No. 20085)

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Emma M. Heber and Estate of Henry D. Heber, Deceased, Emma M. Heber, Administratrix,

Petitioner and Appellant,

vs.

Commissioner of Internal Revenue,

Respondent and Appellee.

Appeal From the Tax Court of the United States.

APPELLANT'S OPENING BRIEF

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STATEMENT DISCLOSING BASIS OF JURISDICTION OF THE TAX COURT AND OF THE COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF SUMMARY OF FACTS AND ISSUES.

The Petitioner (the Appellant) is an individual taxpayer residing in the City of South Pasadena, California. In the Tax Court proceeding and in this Appeal Petitioner represents herself in her individual capacity and as

Administratrix of the Estate of Henry D. Heber, deceased, her late husband.

Petitioner, Emma M. Heber, and her late husband, Henry D. Heber, filed timely, joint, cash basis personal income tax returns for the calendar years 1956, 1957 and 1958 (the years here involved) with the District Director of Internal Revenue at Los Angeles, California, and paid to the said District Director the tax called for by the said returns. The District Director of Internal Revenue at Los Angeles, California and the Collection District administered by him is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit. The taxpayer's Petition to the Tax Court of the United States [Tr. Vol. I Document No. 7, p. 20-29] and Petition for Review [Tr. Vol. I Document No. 34, p. 104-112] set out all of the pertinent jurisdictional allegations.

Relationship of This Appeal With the Companion Case of Commissioner of Internal Revenue, Petitioner, vs. Lillian E. Yaeger, Respondent, No. 20085.

The instant appeal was consolidated for trial before the Tax Court of the United States with the case of *Lillian E. Yaeger vs. Commissioner of Internal Revenue,* T.C. Docket No. 4496-62. The two cases involve deficiencies in personal income tax. The Commissioner of Internal Revenue has taken diametrically opposed positions in the two cases, both before the Tax Court of the United States and in these Appeals which come on together for hearing before the United States Court of Appeals for the Ninth Circuit.

Statement of Issues.

This case involves a deficiency in personal income taxes for the calendar years 1956, 1957 and 1958 in the respective amounts of $291.24, $7,797.50 and $741.56 [Tr. Vol. I Document No. 29, p. 96]. The case was heard before the Honorable William M. Fay, Judge of the Tax Court of the United States at Los Angeles, California on December 2, 1963. The Tax Court had jurisdiction over the issues by virtue of 26 U.S.C.A. § 7442 et. seq. The Tax Court entered its Decision on December 2, 1964, ordering and deciding that there was a deficiency in income tax of Petitioner as above indicated. This Court has jurisdiction to review on appeal the Decision of the Tax Court of the United States by virtue of Section 7482 and 7483 of the Internal Revenue Code of 1954 (26 U.S.C.A. §§7482 and 7483).

The issues before this Court are whether there was error in the Tax Court's Decision in — (a) *Heber et al vs. Commissioner* [T.C. Docket No. 4543-62], that there was an aggregate deficiency in personal income taxes in the amount of $8,830.30 for the reason that amounts received by Petitioner Heber during the years in question were not properly capital gain as treated by Petitioner Heber but should be reported by her and her late husband as ordinary income; or whether in (b) *Yaeger vs. Commissioner* [T.C. Docket No. 4496-62], there should have been an aggregate deficiency of $14,109.04 [Tr. Vol. I p. 9] for the reason that amounts paid by Lillian E. Yaeger to Petitioner Heber were there treated as a

division of income rather than capital payments for the acquisition of a capital asset.

Statement of Facts.

Petitioner Heber and her late husband were individual taxpayers residing in the City of South Pasadena, State of California. They were married in June of 1947 [Tr. Vol. II Tax Court Transcript p. 73] and Mr. Heber passed away July 29, 1962 [Tr. Vol. II Tax Court Transcript p. 73]. Petitioner Emma M. Heber is a registered nurse [Tr. Vol. II Tax Court Transcript p. 73].

On September 2, 1939, Petitioner Heber entered into a partnership agreement with Lillian E. Yaeger, under the terms of which they acknowledged that they were the equal owners of certain real properties described therein as Parcels 1 and 2; that they intended to acquire additional properties in which they were to have an equal interest; that they were to own and operate these and other properties as equal partners; that should either partner become dissatisfied, or desire to withdraw, that such partner should not be permitted to do so before making an offer to either sell to the other, or purchase the undivided one-half interest in the fee ownership of properties fully owned by the other party; and that in the event no sale occurred within a period of thirty days, then the partnership was to be dissolved by operation of law. (Joint Exhibit 8-H). After execution of the said partnership agreement on September 2, 1939, the partnership acquired a liquor store and additional properties designated as Parcels 3, 4, 5 and 6 which were vacant lots, and Parcel 7, a ranch property which was acquired

in January or February of the year 1944 [Tr. Vol. II Tax Court Transcript p. 80]. All of the said properties are described in a document designated "Agreement" dated August 10, 1944 (Joint Exhibit 9-I).

The said document captioned "Agreement", dated August 10, 1944 (Joint Exhibit 9-I), is a written dissolution of the partnership, calling for conveyances, the result of which was to place the fee simple title to all of said parcels in Lillian E. Yaeger and divest Petitioner Heber of any interest therein. The consideration for such transfers is said to be "a life interest in and to one-half of the rents, issues and profits for and during the period of her natural life". Petitioner Heber accepts the position that the said document captioned "Agreement" dated August 10, 1944 (Joint Exhibit 9-I) dissolved the existing partnership and is the basic instrument which purports to fix the present rights of the parties. Under it payments have, from time to time, been made, the nature of which is the principal issue in these two cases. Petitioner Heber does not accept the proposition that said document is in fact an "agreement", or that she can be bound by any of its descriptive terms or any of the language used therein. This is because the said document was prepared by Lillian E. Yaeger's attorney without the knowledge of Petitioner Heber, and because Petitioner Heber was coerced into signing the said document without having read it, and without the benefit of counsel, and at a time when she, Petitioner Heber, was ill. [Tr. Vol. II Tax Court Transcript p. 79].

After the signing of the said document (Joint Exhibit 9-I) on August 10, 1944, Parcels 3, 4, 5 and 6 were sold

by Lillian E. Yaeger, along with the liquor store, and the proceeds of such sales all went to reduce the mortgages on the other properties acquired and then owned by Yaeger. No benefit inured to Petitioner Heber as a result of these sales [Tr. Vol. II Tax Court Transcript p. 57 and p. 70]. Petitioner Heber received only small and spasmodic payments on her "life income" [Tr. Vol. II Tax Court Transcript p. 50], and they ceased entirely from 1948 through the year 1953 [Tr. Vol. II Tax Court Transcript p. 86].

For some time after the document of August 10, 1944 (Joint Exhibit 9-I) Lillian E. Yaeger endeavored to charge to Petitioner Heber depreciation, a manager's salary and other improper items, and co-mingled funds from the properties with other funds. See *Steeve vs. Yaeger,* 145 Cal.App.2d 455, 30 P2d 704. The aforesaid litigation, i.e. *Steeve vs. Yaeger,* was instituted by Petitioner Heber (her name being Steeve before her marriage to her late husband) when she become discouraged with the attitude and delinquencies of Lillian E. Yaeger. As a result of said litigation, and a judgment in favor of Petitioner Heber, Yaeger was required to make and did make large payments to Petitioner Heber in the years here in question.

From and after the critical date of August 10, 1944 until 1947, personal income tax returns were prepared for both Petitioner Heber and Yaeger by a Mr. Hawk, public accountant, who later associated Mr. Stoy, the present auditor and accountant for Yaeger [Tr. Vol. II Tax Court Transcript p. 29]. Mr. Hawk and Mr. Stoy determined Petitioner Heber's methods of report-

ing payments received from Yaeger and established the pattern therefor until Heber ultimately obtained independent advice [Tr. Vol. II Tax Court Transcript p. 30 and pp. 81-82].

The Respondent Commissioner of Internal Revenue is in agreement with Petitioner Heber that if there was a sale or exchange of a capital asset (i.e. a partnership interest or fee ownership of real properties) for a consideration consisting of a different thing of value or bundle of rights, i.e. a life income, then the payments in question were reportable by Petitioner Heber as a capital gain and not deductible upon the income tax returns of Lillian E. Yaeger [Tr. Vol. II Tax Court Transcript p. 14]. This is the issue in the instant appeal.

SPECIFICATION OF ERRORS.

The Tax Court erred —

(1) In not determining whether the Agreement of August 10, 1944 constituted a sale or exchange under the provisions of Section 117 et seq of the Internal Revenue Code of 1939 (Section 1201 et seq of the Internal Revenue Code of 1954);

(2) In finding specifically that Petitioner Heber must report as ordinary income, payments received by her as an income for life, irrespective of whether such payments constituted consideration for the sale or exchange of a capital asset, or whether such life income was paid and received as a liquidating distribution of partnership assets;

(3) In not determining the then fair market value of the life income or life estate as of the date of execution

of the "Agreement" of August 10, 1944, and in further not determining Petitioner Heber's cost or basis of her interest in the partnership;

(4) In not determining that a partner's ownership interest in a partnership, the assets of which constitute real property, constitutes in the hands of the partner a capital asset, and in further not determining whether or not the sale or exchange, or liquidating distribution, of such capital asset results in a sale or exchange giving rise to capital gain or loss under the provisions of Section 117 et seq. of the Internal Revenue Code of 1939 (Section 1201 et seq of the Internal Revenue Code of 1954);

(5) In not determining that the income tax returns filed by Petitioner Heber and her late husband for the years 1956, 1957 and 1958, as amended, were correct in theory;

(6) In determining that there are deficiencies in income tax due from Petitioner Heber for the said taxable years 1956, 1957 and 1958; and

(7) In that its Opinion, Decision and Computation of Tax for Entry of Decision are contrary to law and are not supported by the evidence.

ARGUMENT.

Undisputed Basic Realities.

Certain undisputed facts and circumstances surrounding the relationship of Petitioner Heber and Lillian E. Yaeger, the basic document of August 10, 1944 (Joint Exhibit 9-I) and the true significance of certain trans-

actions and events must be briefly established and understood. These are numbered for brevity and emphasis:

(1) On September 2, 1939 when the "Co-partnership Agreement" was executed (Joint Exhibit 8-H) Petitioner Heber was the owner of a full and unrestricted one-half interest in the partnership and in the partnership assets composed of various parcels of real property. This interest and these assets in the hands of Petitioner Heber constituted a capital asset. (Internal Revenue Code of 1939, Section 117(a) et seq, 26 U.S.C.A. Int. Rev. Code § 117(a) et seq).

(2) The above position of unrestricted ownership of a capital asset or assets continued without change until execution of the document designated "Agreement" on August 10, 1944 (Joint Exhibit 9-I).

(3) On August 10, 1944, Petitioner Heber was compelled to transfer, assign and convey her ownership interest in the partnership and partnership assets consisting of real property to Lillian E. Yaeger. The partnership was thereupon terminated. [Tr. Vol. I p. 68 — T. C. Memo Facts and Opinion, p. 19]. There was not only a conveyance of real properties but a change in the relationship from that of partners to that of fiduciary and beneficiary. "The interests which Heber and Yaeger received in the former partnership properties were substantially altered after the execution of the termination agreement, as were the relationship between Heber and Yaeger and the manner in which the properties were operated and maintained." [Tr. Vol. I p. 68 — T.C. Memo Facts and Opinion, p. 19].

(4) Thus Petitioner Heber on August 10, 1944 exchanged, conveyed and parted with a capital asset or assets, whether voluntarily or involuntarily, and at the same time received in exchange or in consideration thereof a bundle of rights or thing of value, i.e. a life interest in the income of certain properties or the proceeds therefrom, after investment and reinvestment, which properties and values were thenceforth to be wholly owned and exclusively operated by another person, i.e. Lillian E. Yaeger [Tr. Vol. I p. 67 — T.C. Memo Facts and Opinion, p. 18].

(5) The sale or exchange and transfer and acceptance of consideration from and between Petitioner Heber and Yaeger was fully accomplished and completed, its tax significance established, and values became determinable for tax purposes on the said critical date of August 10, 1944.

(6) The facts hereinabove recited, and the sole and only issue with respect to such facts, were stipulated and agreed to by and between Counsel for Petitioner Heber and Counsel for the Respondent Commissioner of Internal Revenue and the Honorable William M. Fay, Judge of the Tax Court of the United States, at the time of trial. See the following statement of the issue and stipulation with respect thereto in open court:

> "Mr. Rhodes: (counsel for Respondent Commissioner of Internal Revenue) If a sale did occur in 1944 the payments made by Miss Yaeger to Mrs. Heber would simply be consideration for the sale of a capital asset, that this would be capital gains, but

in that event Miss Yaeger would be taxable on the entire income from the property.

"The Court: I thought that I possibly misunderstood you, but I did not.

"Mr. Rhodes: That is all, yes.

"The Court: I assume that that is the law, if a sale did occur in 1944 and these are payments then obviously they would be capital gains to the recipient. I do not think there could be any dispute about that.

"Mr. Little: (counsel for Petitioner Heber) No, that is the issue, Your Honor."

(7) The Tax Court of the United States did not decide this issue; it ignored the stipulation of Counsel for Petitioner and Respondent; it did not determine the cost or basis of the capital assets exchanged in the hands of Petitioner Heber, nor did it attempt to establish the valuation of the consideration received by her on August 10, 1944; and it decided the case arbitrarily, erroneously and illegally upon an irrelevant theory of its own not encompassed in or raised by the pleadings or Counsel. [Tr. Vol. I p. 70 — T.C. Memo Facts and Opinion, p. 21].

Sale or Exchange of A Capital Asset in Consideration of A Wholly Different Bundle of Rights or Thing of Value.

Petitioner Heber was and is a nurse [Tr. Vol. II Tax Court Transcript, p. 73]. Lillian E. Yaeger was and is a real estate broker [Tr. Vol. II Tax Court Transcript p.

43]. Petitioner Heber and Yaeger were the owners in fee of an undivided one-half interest in certain real property constituting a capital asset on September 2, 1939 (Joint Exhibit 8-H). On August 10, 1944 an "Agreement" was entered into (Joint Exhibit 9-I) which immediately and effectively dissolved the partnership:

> "Upon an examination of all the facts before us, it is clear that after the execution of the termination agreement and the various deeds mentioned therein, Heber, in lieu of her partnership interest, was left with a life estate in an undivided one-half of the former partnership properties. In lieu of her partnership interest, Yaeger received (1), as a tenant in common with Heber, a present interest in the Fullerton properties, namely a life estate, measured by Heber's life, in an undivided one-half of the properties; plus (2) a future interest, namely the entire fee interest therein upon Heber's death" [Tr. Vol. I pp. 69 and 70 — T.C. Memo Facts and Opinion, pp. 20 and 21].

It is believed that the above quote from the Tax Court's Opinion is significant wherein it recognized that "in lieu of her partnership interest" Petitioner Heber received a life estate in income. A life estate in income, whether it stems from certain identifiable properties, or the proceeds therefrom, is certainly a different thing of different value than an outright ownership of the said properties. On August 10, 1944 there was a significant economic change of position. A taxable event occurred at that time. Lillian E. Yaeger was substantially enriched (Note: If the theory of the Tax Court were to be ac-

cepted this enrichment should have been taxed to Yaeger on August 10, 1944 as a result of her "bargain"), and Petitioner Heber was involuntarily compelled to accept, in exchange for a capital asset, an entirely different thing of lesser but determinable value.

One error made by the Tax Court was to attribute to the "Agreement" of August 10, 1944 (Joint Exhibit 9-I) the aspects of a bona fide arm's length agreement or bargain and sale, and to attempt to bind the respective parties by what was said therein. In its Findings and Opinion the Tax Court was obviously aware of the relationship between the parties and the realities of the situation as may be seen by some of its statements:

> "Thereafter, Yaeger ceased paying any monies to Heber (referring to the date of January 1, 1948) with respect to her interest in the Fullerton properties, but began to pay herself $200 per month as a manager's salary, charging this amount against the rental income produced by the Fullerton properties." [Tr. Vol. I p. 58 — T.C. Memo Facts and Opinion, p. 9].

> "At best, their joint ownership of the Fullerton properties could most adequately be described by that term coined by Roman jurists, a Societas Leonina[3]."

> 3 "This epithet is an allusion to the fable of the lion who, after entering into a partnership with the other wild beasts for hunting, appropriated the whole prey to himself."

[Tr. Vol. I p. 67 — T.C. Memo Facts and Opinion, p. 18]. The Findings and Opinion of the Tax Court on the subject of the so-called "Agreement" (Joint Exhibit 9-I)

are inconsistent and foggy. The Tax Court finds as a fact [Tr. Vol. I p. 54 — T.C. Memo Facts and Opinion, p. 5] "All of the properties of the partnership were managed solely by Yaeger. Heber did not participate in the management thereof". This reference is to the existence of the partnership between the date of the beginning thereof on September 2, 1939 and the termination thereof on August 10, 1944. Then a few pages later [Tr. Vol. I p. 57 — T.C. Memo Facts and Opinion, p. 8] the Tax Court undertakes to interpret the motives of Lillian E. Yaeger (wholly unnecessary and uncalled for) by finding further as follows:

> "Yaeger's purpose in causing Heber to execute the termination agreement was to reshuffle their interests in the partnership properties in order to reflect the fact that Heber, because of illness, had become unable to assist Yaeger in any of the affairs of the partnership".

The Tax Court had already found that Petitioner Heber never did assist Yaeger in the partnership affairs. Her partnership interest and ownership of partnership assets resulted from substantial cash contributions for the purchase thereof, which amounts appear on the amended returns in question as her cost for the capital assets sold. Petitioner's Heber's cost or basis for these capital assets has not been raised by Respondent as an issue.

The point to be made here is that with respect to the critical "Agreement" of August 10, 1944 Petitioner Heber cannot be bound by any of the language used therein nor any of the terms thereof. The said "Agree-

ment" was executed by Petitioner Heber under duress, without counsel, at a time when she was ill, and the said "Agreement" was prepared for her signature and she was required to sign the same by Yaeger and Yaeger's attorney [Tr. Vol. II Tax Court Transcript, p. 79]. Any attempt therefore by the Tax Court to attribute legal significance to the said "Agreement" or to interpret the said "Agreement", as far as Petitioner Heber is concerned, is legally and morally wrong. The Tax Court must be guided solely by the economic realities of what transpired.

Analysis of Petitioner Heber's Substantive Position and Applicable Legal Precedents — Analogy to Involuntary Conversion.

As has been shown and established Petitioner Heber, through the execution and recording of formal grant deed conveyances, fully divested herself of an outright ownership in real properties. (Joint Exhibits 10-J, 11-K and 13-M). One of the principal questions to be decided is whether or not a sale or exchange took place on August 10, 1944 at the time of the so-called "Agreement" and the execution and recordation of the said conveyances. A related question or companion question is whether or not this substantial change of economic position and the exchange of a capital asset or assets, i.e. a partnership interest or the underlying real properties involved, constituted an incident or event having at the time taxable significance.

In reading a multitude of cases and commentaries on this general subject, one frequently finds that decisions

turn on issues of motivation, sound business reason or frivolous transactions whose sole object is tax avoidance. Here, as is plainly apparent, there was no bargain or sale in that there was any meeting of the minds or voluntary negotiation, since Petitioner Heber was coerced into her actions by highhanded methods and the domineering insistence of Yaeger. However, having been so mistreated, Petitioner Heber can certainly not be denied any redeeming tax advantages to which the realities might entitle her. An analogy might be drawn here to the cases having to do with involuntary conversions, which it is uniformly held result in capital gains or losses (*Commr. v. Peterman, et al.*, 118 F2d 973 (C.A. 9 1941).

Analogy to An Annuity.

If the motivations and intentions of either of the parties with respect to the August 10, 1944 "Agreement" are controlling, and if such intentions and motivations are to be resorted to in interpreting the "Agreement" (and it is submitted that they should be), these would certainly have to be the intentions and motivations as expressed by Lillian E. Yaeger. Petitioner Heber had no hand in drafting the "Agreement" and was compelled to sign it against her wishes and, therefore, cannot be bound by its terms.

At the Tax Court trial Lillian E. Yaeger was asked both on direct and cross-examination what her intentions were on August 10, 1944 with respect to Petitioner Heber as follows:

> "Q: (by Mr. Dodge, Counsel for Yaeger) What was the agreement between you and Mrs. Heber, and

why was it entered into, concerning the division of the properties at August 10, 1944?

A: Well she was ill and I wanted to give her an income for the rest of her life."

[Tr. Vol. II Tax Court Transcript, p. 50]; and

"Q: (by Mr. Little, Counsel for Petitioner Heber) Now, Miss Yaeger, I am almost through here. With reference to the document dated August 10, 1944, you say this was executed at the time when Mrs. Heber was ill?

A: That's right.

Q: I note in the Agreement that it provides that in the event of illness of the parties, and the income is not adequate, that the properties may be invaded to take care of them.

A: That's true.

Q: I believe that you stated that in view of the fact that she was ill you wanted to see her have an income for life, is that right?

A: I did, yes sir.

Q: Did you insert this reference to medical care into the Agreement again having in mind her illness and —

A: Whatever the contract says.

Q: Yes. Who prepared this document of August 10, 1944?

A: Our attorney.

Q: Now you say 'our attorney,' —

A: Yes sir.

Q: — Who is that?

A: Mr. Harvey." (Yaeger's personal attorney).

[Tr. Vol. II Tax Court Transcript, pp. 60 and 61].

In determining whether or not there has been a taxable sale or exchange of a capital asset, or merely an inconclusive or tax-motivated rearrangement of the interests of the parties without tax significance, it is necessary to determine whether or not the so-called "seller" divested herself of a tangible capital asset in exchange or consideration for some other or different thing of value, i.e. a different bundle of rights or a different property value. Here we clearly see that it was the motive and intention of Yaeger, respectively submitted to be the only motive or intention to which we can look, that she with maternalistic beneficence intended to give, in exchange for conveyance of title to real properties, an "income for life", and Yaeger and her attorney even added to this annuity-like consideration medical benefits with provisions for invasion of the corpus if Petitioner Heber were to fall ill and monies from the properties were not available. This further clearly shows that income from the properties was not looked to as the sole source of amounts to be payable to Petitioner Heber.

The Tax Court made no effort to determine the value of this annuity-like promise of an income for life (if its value could be determined) and made no effort to determine what the enrichment of Lillian E. Yaeger might have been as a result of this sale or exchange, or what the impoverishment or loss of Petitioner Heber

might have been as a result thereof. The consideration and the values of identifiable assets flowing from one party to the other were obviously dispropriate and not of like kind.

Analysis of the Problem From the Standpoint of An Identical Transfer and Exchange of Considerations, If The Same Were to Occur Between Unrelated Parties, Rather Than Related Principals.

We find the following commentary in Merten's Law of Federal Income Taxation, Volume 3 B, Section 22:98, Page 404:

"In the reasoning found in support of these decisions the courts have sometimes pointed to the circumstance that if the particular item, such as a lease or a contract, had been sold to a third party instead of being released to the other party to the arrangement the gain derived therefrom would have been capital gain.[11] The opinion was then expressed that no different result should follow in the case of a release. The conclusion that the two types of situations should not have different tax consequences is sound, but places in question the results reached in earlier cases which inconsistently found a sale or exchange to be missing where there was a release or compromise of debt. In the effort to reconcile other cases, comment is made in some of the cases that the release pertained to or affected physical property where capital gain treatment was allowed.[12]

[11] Comm. v. McCue Bros. and Drummond Inc., 210 F2d 752 (C.A. 2d, 1954) Cert. den. 348 U.S. 829, and other citations.

[12] Comm. v. Starr Bros., Inc., 204 F2d 673 (C.A. 2d, 1953); Comm. v. Goff, 212 F2d 875 (C.A. 3d, 1954), cert, den 348 U.S. 829."

In viewing the relationship between the parties involved in this Appeal, and particularly from the standpoint of Petitioner Heber, the above test would certainly seem a logical way to approach the problem. If the "Third Party Test" should be the law, the ultimate conclusion could hardly be in any doubt.

Let us assume for the moment that Petitioner Heber in August of 1944 were to approach a third party stranger and represent to that stranger that she was the owner of record of an undivided one-half interest in certain real properties. Let us then assume that Heber were to propose to this third party stranger that she would convey outright title, without any strings attached, to her interest in the said real properties in exchange for or in consideration of one-half of the income therefrom for life, plus the provision that in the event of her illness and income was not sufficient, the corpus or principal, or other funds, would be invaded to assure the lifetime income and security of Petitioner Heber. Could there then be any doubt that there was a sale or exchange of capital assets giving rise to a capital gain? And is there any logical reason why the instant situation should not be viewed in the same manner?

Monies Received by Petitioner Heber Not Attributable to Identifiable Assets Solely — Analogy to A Trust.

The basic document of August 10, 1944, as hereinabove stressed, provides for the payment of medical expenses of Petitioner Heber out of "principal" or "corpus" in the event of her illness, should income from the properties be insufficient for such care. The Court,

in the case of *Steeve vs. Yaeger*, 145 C.A.2d 455 at pages 464 and 465, found and held that Petitioner Heber was entitled to medical expenses to be paid out of corpus; and the Court further found that there was a "confidential relationship between the parties" and that Yaeger had co-mingled income from the properties and used portions thereof for her personal expenses. These facts and the determinations tend to support a theory that Petitioner Heber's position, whatever it may elsewhere and otherwise be designated, was comparable to that of a beneficiary under a trust, and that under a fiduciary relationship Yaeger was required to make payments to her and care for her. This is in accord with Yaeger's own testimony at the Tax Court hearing [Tr. Vol. II Tax Court Transcript pp. 60 and 61] and tends to support the trust or annuity theory, since the obligations of Yaeger go beyond identifiable assets, and the specific income therefrom. It should be noted that Yaeger had absolute control and ownership of all of the assets involved. It should also be noted that some of the properties conveyed by Petitioner Heber to Yaeger were not income producing properties but were in fact investment properties to be indefinitely owned and held by Yaeger. This is true of the most valuable piece of property of all, namely Parcel 7 or the so-called ranch property [Tr. Vol. II Tax Court Transcript p. 48], and some of the properties conveyed by Petitioner Heber to Yaeger were promptly sold, and the proceeds thereof went to reduce mortgages on other properties, including non-income producing investment properties, then solely owned by Yaeger. [Tr. Vol. II Tax Court Transcript p. 70].

Sale or Exchange Giving Rise to Capital Gain or Loss.

A basic contention of Petitioner Heber, stipulated to by Respondent, and one which the Tax Court erroneously failed to consider or decide, is that on the critical date of August 10, 1944 there was a sale or exchange of a capital asset giving rise at that time to the recognition of capital gain or loss. That Petitioner Heber's partnership interest, or her absolute ownership of an undivided one-half interest in the underlying real properties, constitutes a capital asset under the then prevailing law, can be in no doubt whatever. (Internal Revenue Code of 1939, Section 117(a), 26 U.S.C.A. Int. Rev. Code § 117(a); and Regs. 111 Sec. 29.117 et seq.). Nor can there be any doubt that under the applicable law and decided cases, disposition of such capital assets under the facts in the instant case constituted a sale or exchange of capital assets, giving rise to taxable capital gain or loss. See *U.S. v. Adamson,* et al, 161 F2d 942, (C.A. 9 1947). In that case the Appellate Court quoted with approval the following comments of the United States District Court:

> "The Court: It seems to me that the Stilgenbaur case (9 Cir., 115 F2d 283) is binding, in the light of the stipulation of facts and in the light of the agreement which was entered into in this case. That decision holds that any method of terminating the partnership, whether it be by mutual agreement dissolving the partnership and a withdrawal of capital by one partner, or whether it be sold to outsiders, or whether it be by the legal process of dissolution, any one of these is treated by the Ninth Circuit as a sale, and taxable as capital loss or gain, and not as income.

For that reason, the judgment should be for the plaintiff, and it will be so ordered."

In the instant case there was no conversion or anticipation of accrued profit or future income, and Petitioner Heber certainly had no such intention or motive. Petitioner Heber was compelled to do what she did but the substantive realities of the transaction were the receipt of a present consideration by her (security for life without the burdens of ownership) in exchange for existing ownership and all of the benefits and burdens inherent in the ownership of real property.

The Tax Court's Irrelevant Theories and Wrongful Conclusions.

The Tax Court in its Opinion (Tr. Vol. I pp. 70 and 71, T.C. Memo Facts and Opinion, pp. 21 and 22) stated as follows:

"Therefore, whether we conclude (1) that Heber sold her partnership interest to Yaeger in return for a life estate in an undivided one-half of the Fullerton properties or (2) that Heber received said life estate as a liquidating distribution, in kind, upon the dissolution and termination of the partnership, Heber, nevertheless, must report, as ordnary income (reduced by any available deductions for amortization or depreciation), her 50 per cent share of the net rental produced by said properties and attributable to her life estate therein."

First, the Tax Court overlooks and ignores the pleadings in this case and the stipulation between Counsel for

Petitioner Heber and Counsel for Respondent establishing that the issue to be decided was whether or not there was a sale. The cases of *Bernstein vs. U.S.*, 253 F2d 19 (C.A. Mo. 1956) and *Berry vs. Commr.*, 254 F2d 471 (C.A. 9 1958) hold that stipulations entered into by the parties are binding and conclusive and the courts are required to enforce the same, and that such stipulations by counsel cannot be disregarded in the Appellate Courts.

Secondly, the Tax Court's Opinion is erroneous as a matter of law and the Tax Court fails to make necessary findings and determinations because of its irrelevant theory.

There was a sale or exchange on August 10, 1944 and it is ridiculous to discuss "distributions of partnership assets *in kind*" (emphasis added). Certainly any sort of a distribution of assets *in kind,* as and between two partners each owning an equal undivided one-half interest in valuable real properties, would contemplate some sort of equality as to the assets distributed. Here Yaeger grabbed all the marbles. She grabbed both the burdens and benefits of ownership. She also expressed a protective interest in Heber's security and medical care and stated that she wanted her to have "an income for life". Petitioner Heber's wishes and intentions are of no importance since this determination was purely an expression of the will of Yaeger. To characterize this as a "distribution of assets in kind" is patently absurd.

The Tax Court was put to the clear duty of (1) determining the fair market value on August 10, 1944 of the life income according to annuity valuation precedents

(see a discussion of the valuation of life incomes and life estates, Merten's Law of Federal Income Taxation, Volume 3 A, §21:26); *or* (2) deciding that the fair market value of Petitioner Heber's income for life was not determinable as of August 10, 1944 and that the only appropriate method for reporting her capital gain would be on the installment basis measurable by actual payments received and reported from year to year. The Tax Court, with the cost to both Petitioner Heber and Yaeger of their ownership interests available and uncontested, wholly ignored the disproportionate values in the hands of the respective parties after August 10, 1944; i.e. Petitioner Heber had an income for life but Yaeger had an equal income for life *plus* outright ownership of all the properties. The significance of this fact cannot be ignored or characterized as a "reshuffling of their interests in the partnership properties". *This is the essence or ultimate point which the Tax Court bypassed and left undecided.*

The Tax Court ignores those cases which have held that the transfer of a life estate in a capital asset results in capital gain or loss. In *Bell's Estate vs. Commr.*, 137 F2d 454 (C.A. 8 1943), the Court held that where life beneficiaries of a trust transferred their interest to the remainderman, in consideration of cash and securities, the amounts received constituted proceeds of sales of capital assets and not, as the Commissioner contended, ordinary income. Similar conclusions were reached in *McAllister vs. Commr.*, 157 F2d 235 (C.A. 2 1946) and *Estate of Camden vs. Commr.*, 139 F2d 267 (C.A. 6 1943). The above cases are somewhat the reverse of the

facts presented here on Appeal, since in those cases the life tenant surrendered to the remainderman his right to receive income in exchange for a present cash consideration or other thing of value. This was held to result in a capital gain to the life tenant or beneficiary of a trust on the theory that under the decision of *Blair vs. Commr.*, 300 U.S. 5 (1937), assignments of life interests in these instances constituted transfers of an interest in the trust assets rather than a mere assignment of the naked right to income. In the instant case, and as apparently decided in *Steeve vs. Yaeger* (supra), there was a wholly disproportionate surrendering of title to the properties themselves in exchange for a life estate in income. If this constituted a sale or exchange under the above authorities, certainly it would constitute a sale or exchange in our case. *To accept the Tax Court's superficial decision would be to ignore the cost or basis of capital assets in the hands of the respective parties, both before and after the taxable incident, and to assume that there was a simple "reshuffling" of the same assets with no taxable significance and with the tax burden upon income to be equally borne by the respective parties, in spite of the wholly unequal position of the respective parties after the "bargain".*

CONCLUSION.

The Tax Court's Findings of Fact and Opinion are without support, either in the applicable and appropriate law or in logic, if this case be without precedent; and its Findings of Fact and Opinion wholly fail to make necessary determinations in order to properly define and allocate the tax burdens involved in these Appeals.

Therefore, it is respectfully submitted that the Tax Court's Decision, as based upon its Findings of Fact and Opinion, is erroneous, and it is respectfully urged that the same be reversed or remanded.

Dated: August 27, 1965.

Respectfully submitted,

F. EDWARD LITTLE
Counsel for Petitioner and Appellant.

CERTIFICATE.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

F. EDWARD LITTLE

No. 20074

IN THE

United States Court of Appeals
For the Ninth Circuit

K-91, INC.,
Appellant,

v.

GERSHWIN PUBLISHING CORPORATION, et al.,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

HONORABLE GUS J. SOLOMON, *Chief Judge*

REPLY BRIEF OF APPELLANT

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METROPOLITAN PRESS SEATTLE, WASHINGTON

SUBJECT INDEX

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STATUTES

IN THE

United States Court of Appeals For the Ninth Circuit

No. 20074

K-91, Inc.,
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Appeal from the United States District Court for the Western District of Washington, Northern Division

Honorable Gus J. Solomon, *Chief Judge*

REPLY BRIEF OF APPELLANT

SUMMARY OF APPELLANT'S REPLY ARGUMENT

After reading appellees' answering brief we have again searched it for case authority. We have, for all practical purposes, found none. Those few cited are analyzed in Appendix A. Appellant challenged appellees to distinguish the cases cited by appellant. But, presumably because appellees could not meet the challenge, they ignore the cases entirely.

Similarly, appellees almost entirely ignore making any reference to the record below. Rather, they refer repeatedly to the trial court's findings and conclusions.

It is these findings and conclusions from which appellant is appealing. As appellant demonstrated in its opening brief, the trial court's findings and conclusions in this type of proceeding carry practically no weight at the appellate level (Appellant's Brief, p. 34). For recent authority in an anti-trust case squarely in point see *Associated Press v. Taft-Ingalls Corporation*, 340 F.2d 753 (6th Cir. 1965), at page 765:

> "It is our obligation as an appellate court to overrule the 'clearly erroneous' findings of the district court in an anti-trust case, as in other civil actions tried by a district judge without a jury."

Appellees acquiesce in this, but repeatedly assert in effect that the trial court's findings are sustained because the trial court found them and that proves them. This reply brief will not just repeat appellant's previous arguments. They have been set forth and gone unanswered. Appellant will reply to appellees' arguments but without much additional reference to the cases or record because these are adequately supplied in appellant's brief.

VIOLATIONS OF WASHINGTON STATE STATUTES

The Power of States to Regulate Pooling of Copyrights

Appellant in its opening brief reviewed Ascap's own extensive litigation on the exact issue of state power to legislate in the area of musical copyright combinations (appellant's brief, 15-17). Appellee declined to even mention these cases, let alone analyze them, and cites such remote cases as labor disputes. Those cases are reviewed in Appendix A herein. We can only assume

that, like the federal anti-trust cases, appellees cannot distinguish them, and so ignore them.

Appellees' Arguments That Per Program Licenses Are Really Per Piece

Appellees contend that they satisfy the per piece requirements of the Washington law because of the Ascap per program license. They say that, for some unexplained reason, it would be difficult to establish a price for each piece of music. They make this contention without the basis of *any* evidence whatsoever. The *only* evidence, coming from several witnesses, was that it would be quite feasible to list the price of music. This evidence is set forth in appellant's opening brief in Appendix H. In *U. S. v. Loew's, Inc.*, 371 U.S. 38, 9 L.Ed.2d 11 (1962), the Supreme Court rejected the identical argument and demanded that each film be quoted at a set price.

Appellees relate that the same price should not be charged for "A La Cubana" as for "Easter Parade." That is precisely our point. The price should be on a per piece or per play basis as the Washington legislature demanded—not on gross. When the consumer buys a phonograph record from the record store he pays various prices for various records—competitively—as it should be. The same should be true for performance rights. In order to buy a phonograph record the consuming public doesn't have to pay 8 per cent of its gross income regardless of which record is purchased. But, under the Ascap per program license, if a broadcaster grosses $50

for a one-hour program in which one record is played, he must pay $4 (8 per cent of his gross) whether the record is "A La Cubana" or "Easter Parade." Or whether 30 seconds of music is played or 59 minutes.

It was obviously this precise evil which the Washington legislature had in mind when it outlawed blanket licenses per se. It then went on to require per piece licenses *as a condition* to allowing composers to pool their performance rights. (RCW 19.24.020) *But it did not make blanket licenses legal.*

Appellees admit that Ascap uses blanket licenses in Washington. Thus they are violating RCW 19.24.020 without regard to the question of whether a per program license is "per piece."

Appellees argue that the Washington legislature must have meant per program when it said "per piece." The Washington legislature said just what it intended to say, "per piece." If it had intended to say "per program" it would have. Even in 1937 we can assume the legislature knew the difference between a piece of music and a radio program. Some of the most popular radio *programs* of the general era were made up of several *pieces*, e.g., The Hit Parade, The Fred Waring Program, The Telephone Hour.

The legislature expressly *defined* what it intended by the phrase "per piece" as being ". . . so much money per each time a piece of music is played or used in a public performance for profit" (RCW 19.24.140).

Appellees also contend that per program licenses should be construed to be per piece licenses within the meaning of the Washington law because the Amended Final Judgment requires Ascap to issue a per program license. Apparently appellee thinks that when a defendant (Ascap) is caught violating the federal anti-trust laws and enters into an agreed order, that comity requires a different interpretation of a state law—some kind of retroactive legislation by two non-legislative groups located in the state of New York. The consent decree was entered in 1941, four years after the Washington law was enacted.

Although appellees keep stating that the Amended Final Judgment is everyone's delight, the simple fact is that only the U. S. Justice Department and Ascap's management have any standing to question its wisdom. Disenchanted rank and file members of Ascap have attempted to intervene, but the United States Supreme Court ruled it was a matter between only Ascap and the government and no one else has any voice in it. *Sam Fox Publishing Co. v. United States,* 366 U.S. 604 (1961). (Appellant's Brief 115-119.) When the All Industry Committee attempted to get different licenses from those provided in the consent decree, the broadcasters were told the same thing. *United States v. Ascap,* 331 F.2d 117 (2d Cir. 1964).

It is preposterous to argue that a decree which binds only Ascap, which no one else has any standing to contest, which is not even a law but a judgment, which can be and has been amended from time to time, has any-

thing whatever to do with the interpretation of a Washington statute. Are we to assume that each time that Ascap agrees to another amendment of the Amended Final Judgment that a 1937 Washington law is to have a different interpretation?

Appellees also contend that not only the state legislature meant to say "per program" instead of "per piece" in 1937, but that the legislature's legal advisor in 1962 was wrong when he issued an opinion to a state senator that the Ascap per program license was another form of blanket license and therefore illegal (Def. Ex. A-14). In so doing, appellees will have to include Ascap's own chief attorney who testified *under oath* before Congress on at least two occasions that the per program license was only another form of blanket license. (Testimony quoted at page 45, Appellant's Brief.)

Finally, appellees contend that they comply with the Washington statute because all members of Ascap under the Amended Final Judgment are free to deal separately. It is a stipulated fact that this is *an impossible alternative* (R. 30, Agreed Fact 50, pp. 10-11). Even if it were possible in Washington, the members do not offer licenses individually.

It is again a *stipulated fact* that the *only* licenses made available are those contained in the files of the Washington Secretary of State (R. 30, Agreed Fact 25 and 28, p. 6). The *only* licenses filed there are the per program and blanket licenses as far as the broadcasters are concerned. There are per piece licenses available to every

other user of music in Washington (Def. Ex. 7, 8, 8-A, Schedule 11), but broadcasters are *expressly excluded.* As previously pointed out, no other users of music are licensed in the State of Washington or pay any fees whatsoever (R. 30, Agreed Fact 21, p. 5).

Appellees even admit in their brief that the only licenses made available by the individual Ascap members to broadcasters are the "per program" and "blanket" licenses when they say any filing the members might make with the Secretary of State would be a duplicate of the filing made by Ascap for its members (Appellant's Brief, p. 25).

Notwithstanding the terms of the Amended Final Judgment, in Washington the individual members of Ascap do not make individual licenses available. As to the rest of the United States, the assertion that they stand ready to deal is an empty platitude. *The fact is that there are no such licenses in existence* (R. 30, Agreed Fact 60, p. 11).

The 1959 Proceedings Before Judge Ryan

Appellees state that the most important single fact in this case was the 1959 proceedings before Judge Ryan. Appellant fails to see that it is of much significance at all. Appellant was not even a party. However, since appellees find it so all-important, appellant feels compelled to comment.

As usual, rather than cite what the facts are, appellees cite the trial court's interpretation. They quote the trial

court's finding that in 1959 Judge Ryan ruled that, in the circumstances presented, Ascap would not be required to issue licenses in Washington. The *stipulated facts* (R. 30, Agreed Fact 73, p. 13) and Judge Ryan's order recites (Pl. Ex. 12) that, when the Washington broadcasters applied to that court for a reasonable license fee pursuant to Section IX, Ascap *refused* to issue them any licenses whatsoever. Not only the petitioners were refused a license, but everyone else in the whole state —even those broadcasters that appellees admit have faithfully paid tribute to Ascap over many years.

Appellees repeatedly assert that appellant had at all times the right to apply for a blanket or per program license under the Amended Final Judgment. For the many reasons related in appellant's two briefs it, of course, declined to do so. (See *Hazeltine Research, Inc. v. Zenith Radio Corporation,* 239 F. Supp. 51 (1965) at 72, where the court holds that one may properly refuse to take a license when the alternatives are coercive.) Now, add to those facts the 1959 proceedings and we find that when an application was made, Ascap demonstrated its immense power by refusing *anyone* licenses, subjecting all users of music to possible damages of up to $5,000 per performance. If the 1959 proceedings are important at all, *those* are the reasons, not what Judge Ryan thought about the effect of the Washington law in an order submitted to him under great distress and intimidation.

If Ascap was guided by the 1948 Attorney General's opinion, as appellee asserts, and the trial court "found,"

why did Ascap pull all of its music out of Washington in 1959—even as to broadcasters who religiously paid? Why has it never licensed any other music user in this state?

Since appellees make such an issue out of appellant's failure to pay Ascap even now, may we remind appellees that that is exactly what this litigation concerns. (Again, see *Hazeltine Research, Inc., v. Zenith Radio Corp., supra.*) The damages in this suit come to less than the cost of printing appellant's two briefs. What is important to appellant is that broadcast music be freed for competitive pricing as was done in *Alden-Rochelle v. ASCAP*, 80 F. Supp. 888 (S.D. N.Y. 1948), for movie performances. (Since appellees went off the record to inform the Court as to appellant's present status of license payments, appellant has taken the liberty of completing the story in Appendix B.)

One more critical factor bears on the importance of the 1959 order to the present case. That order only approves the forms of licenses that were attached to the order. The licenses affixed to the order provide by their own terms that they must be construed under the laws of *New York* (Pl. Ex. 12, 6; Def. Ex. 7). Relying on this, in the Washington State Superior Court action in Yakima, Washington, *Cascade Broadcasting Co. v. Ascap*, Cause No. 45877, Ascap contended that the licenses signed by Cascade Broadcasting Co. (a 1959 petitioner) should be construed under the laws of New York rather than the laws of Washington. The Washington court properly held, however, that

> ". . . the laws and decisions of the State of Washington are applicable to the agreements between the parties any provisions in said agreements notwithstanding." *Cascade Broadcasting Co. v. Ascap*, Superior Court Cause No. 45877, County of Yakima, Washington.

The court relied on *Carsten Packing Company v. So. Pac. Ry.*, 58 Wash. 239, 108 Pac. 613 (1910), that parties may not circumscribe the public policy of a state by conveniently agreeing that another state's laws apply. Therefore, the Washington courts have made the 1959 order a nullity because the licenses approved by the order *must* be construed under Washington laws and *not* under New York laws as Ascap might like.

Lastly, how appellees can say no Washington official has criticized Ascap's filings is puzzling, to say the least, in view of the Attorney General's opinion of 1962 that the per program was really a form of blanket license and illegal, making the only two licenses offered in Washington illegal (Def. Ex. A-14).

Appellees find comfort in the fact that neither they, nor Ascap, or Washington broadcasters who deal with Ascap, have been prosecuted. We assume they found the same comfort between the original Final Judgment in Civil Action No. 13-95 when the Justice Department took no further action until the *Alden-Rochelle* cases and *M. Witmark & Sons v. Jensen*, 80 F. Supp. 843 (D. Minn. 1948), in which Ascap was found to be guilty of anti-trust and copyright abuses in nearly every aspect of Ascap's operation despite the 1941 decree. The Justice

Department did not move in on Ascap, just as it does not now, and just as Washington officials have declined to do. But that doesn't make it right or legal, as *Alden-Rochelle* and *Witmark* so amply demonstrate. More important, the argument that failure to prosecute is persuasive of anything at all in the present case is not worth further comment. If public prosecutors were infallible, Congress would not have provided for private rights of action in the anti-trust law.

THE AMENDED FINAL JUDGMENT

Appellees' central argument on the federal issues of anti-trust violations and abuse of their copyrights is to ignore the cases appellant cites and hide behind the consent decree. Their main thrust is that the high-sounding words of the consent decree guarantee competition and fair play for all. All users of music, they keep saying, are guaranteed equal treatment and protection.

Then may we ask why—if the consent decree guarantees all of these things—broadcasters in the United States pay more than 87 per cent of Ascap's total revenues and less than 13 per cent (R. 30, Fact 48, p. 9) is paid by all other users combined, which include all bars, grills, taverns, night clubs, restaurants, seasonal resorts, lounges, occasional or one night bands, dance halls, roller skating rinks, ice skating rinks, rodeos, wrestling, ice hockey, roller derbies, walkathons, professional football and basketball, fashion shows, wired and recorded music not cleared at the source, dog tracks, horse tracks, amusement parks, carnivals, music in industry,

circuses, sound trucks, home shows, expositions, picnic groves, boats, popular concerts, extravaganzas, western revues, variety shows, railroad cars, department stores, hotels, ballrooms and symphonies. (These are among the separate Ascap licenses filed with the Washington Secretary of State, Def. Ex. 7, 8). *In the State of Washington all combined pay zero.*

Even within the broadcasters the consent decree falls far short of providing any so-called equal treatment. Why, for example, can Ascap hire lawyers, monitors, etc., and bring infringement suits against 11 small radio stations as they did in these proceedings, and not even bother big network affiliated radio and TV stations? For just one example, KVOS-TV, a CBS network affiliate, wasn't sued, and is not licensed (R. 31, Admission Nos. 8, 9, 10). CBS owns Columbia Records, Inc., one of the largest recording companies in the United States (R. 31, Admissions Nos. 12, 13).

Why is it the networks, movie exhibitors, background music users, jingles, etc., are cleared at the source, but not broadcasters? The answer to why these and the other flagrant abuses previously related exist is because Ascap was formed in 1914 before broadcasting came into existence.

The broadcasters were not a party to the consent decree, were not consulted when it was entered, and cannot request that it be amended. *U.S. v. Ascap,* 331 F.2d 117 (2d Cir. 1964). When the government and Ascap entered into the decree the government did not

protect the broadcasters. Just as the *Alden-Rochelle* and *Witmark* cases proved it had not protected the movie industry.

Even though Ascap had "only" the non-exclusive license rights it still has today, the movie industry prevailed in the *Alden-Rochelle* and *Witmark* cases. Appellees say those cases are only of historical interest because the *Alden-Rochelle* decree was vacated. Of course it was—after the consent decree was amended in 1950 to conform to the findings of the court. It prohibited Ascap from ever "collecting any monies from, or negotiating with any motion picture theatre exhibitor . . ." (Para. IV. E). It compelled clearance at the source, which is done on a competitive basis, rather than the old abuse of licensing on gross receipts or number of seats. The theatre owner still pays Ascap, but by purchasing a competitively priced film, which he can take or leave on price alone. It wasn't the consent decree that produced this right. It was anti-trust litigation, just like this action, and which the broadcasters were expressly invited to bring by the Second Circuit Court of Appeals. *United States v. Ascap*, 331 F.2d 117 (1964). As the Supreme Court said about the consent decree, private litigants simply are "not bound by government litigation." *Sam Fox Publishing Co. v. U.S.*, 366 U.S. 604 (1961).

The consent decree has not changed much of anything for the broadcasters. Prior to 1941, Ascap charged broadcasters a percentage of their gross under a blanket license. Out of the over 5,000 radio stations, over 98

per cent are still paying on a blanket license on a percentage of their gross. What has changed? The "per program" license is window dressing. Their attempts to amend the decree have failed.

The whole concept of the consent decree is wrong. It substitutes a fantastically cumbersome procedural process that, for the average broadcaster, has accomplished nothing. The alternatives as stipulated are impossible.

For broadcast performance rights there has *never* been competition. What Congress feared when it passed the Copyright Act of 1909 happened just five years later when Ascap was formed in 1914. Copyrights were compounded one on the other and the pooled combination came into being.

The trial court missed the whole point in supposedly "balancing the equities" and finding no other system would work. The reason another system has not worked is because the consent decree will not allow a natural system to evolve. The Justice Department and Ascap have been allowed to substitute their own judgment and now the trial judge has said he, too, knows what will or will not work, and what is best for the public.

The only way performance rights for radio and TV use can find their value—so that "Easter Parade" can be selected and its composer remunerated according to its worth, and "A La Cubana" find its deserving repose—is for this court to free the performing rights to the

music as Judge Leibell did in *Alden-Rochelle.*

As each new radio station comes on the airways to try to please its listeners, it finds itself with very few sponsors. It plays a great deal of music and has only a few commercials. Consequently, it pays Ascap relatively little. As the station builds an image and an audience, it has more commercials and plays less and less music. The *less* music it has time for, the *more* it pays for the music. This is the stigma of the consent decree.

We hope this court will give this station the opportunity to pay for only the music it needs, and to do its own bargaining for it, rather than the Justice Department, Ascap, or even a Federal Judge.

Finally, appellant cannot put it more strongly than to state that it defies the appellees—or anyone for that matter—to distinguish rationally the following cases and their rulings from the present case: *Associated Press v. Taft-Ingalls Corporation,* 340 F.2d 753 (6th Cir. 1965); *Hazeltine Research, Inc., v. Zenith Radio Corporation,* 291 F. Supp. 51 (N.D. Ill. 1965); *United States v. Loew's, Inc.,* 371 U.S. 38 (1962); *M. Witmark & Sons v. Jensen,* 80 F.Supp. 843 (D. Minn. 1948); *Alden-Rochelle, Inc., v. Ascap,* 80 F.Supp. 888 (S.D.N.Y. 1948).

The appellant did not cite the *Associated Press* case in its opening brief because appellant's counsel did not discover the case before the brief was printed. Appellant

submits that the case is exactly comparable to the present case on the anti-trust issues, just as the *Hazeltine* case is.

In the *AP* case the court, at page 756, summarized the issue of that case *and this one* thusly:

> "This AP policy and practice of 'tying' four wire services together in a single 'package' and requiring the appellant to take and pay for four wire services in order to receive any one of them is the principal issue on the appeal."

AP sued the subscriber newspaper for breach of contract for failure to pay fees for the AP news services. The newspaper, as in the present case, defended alleging violation of the anti-trust laws. The district court held for AP and awarded damages. The Circuit Court reversed, stating, at page 762:

> "Yet the record clearly established that AP required appellant to continue to subscribe and pay for three wires which appellant did not want and need, in order to receive a fourth wire which it considered essential, and thereby forced appellant to give up its independent judgment as to whether to subscribe to the three unwanted and unneeded services. This is one of the situations which is 'an object of anti-trust concern.' *United States v. Loew's, Inc., supra,* 371 U.S. 38, 44-45, 83 S. Ct. 97, 102."

The court further pointed out that the practice of packaging news services had been adhered to consistently by AP since 1935. The mere fact that no one challenged it for thirty years is inconsequential, contrary to what the appellees say.

Note that exact similarity of the cases. Ascap requires broadcasters to subscribe to all of the compositions in

its repertory in order for a station to receive any one of them. As the testimony at the trial showed and the stipulated facts established beyond question, the radio station KIXI needs and uses only a small number of carefully selected popular standards. It should not be forced by Ascap to give up its independent judgment and subscribe to unwanted and unneeded compositions such as rock and roll, country-western, or symphony. As before stated, appellant should not be required to allow Ascap, the appellees, the Justice Department or a federal judge to force it to take and pay for unwanted and in many cases inferior music.

Respectfully submitted,

Ronald A. Murphy
Attorney for Appellant
K-91, Inc

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

Ronald A. Murphy
Attorney for Appellant

APPENDIX A

***Alfred Bell & Co. v. Catalda Fine Arts, Inc.*, 191 F.2d 99 (2d Cir. 1951)**

Appellees cite this case for the proposition that a nominal or marginal violation of the anti-trust laws will be subordinated to the copyright privilege. A simple reading of that case will demonstrate that the Court found there was *no* violation of the anti-trust laws, that, in fact, nothing of any consequence regarding anti-trust matters even took place in the United States, that the defendants did not have this defense in mind when they infringed, and that it was not even originally alleged as a defense to the infringement action (Footnote 32, page 106).

Clearly the *Catalda* case has no applicability to this case, where the anti-trust aspects of the case were asserted and emphasized from beginning to end and are hardly marginal. In addition, even if there were no anti-trust aspects to the present case at all, appellant should prevail under the teachings of the many cases cited by appellant that the abuse of a copyright prevents further exploitation of it by successful infringement actions.

***Automobile Workers Union v. O'Brien*, 339 U.S. 454 (1950)**

This is a case dealing with the National Labor Relations Act and has absolutely no application to the present case. Appellant takes no issue whatsoever with its holding. The case involved a statute of the State of

Michigan that was held invalid because it directly "conflicts with the federal Act" in several respects, such as shortening the time for a strike notice from the federally required sixty days to twenty days, and requiring a majority authorization of the strike.

The case arose in the state courts to test the validity of the state act. When Ascap attempted to test the copyright Protection Act in the State of Washington, it was thrown out of court for having "unclean hands" on both occasions. *Buck v. Gallager,* 36 F.Supp. 405 (D. Wash. 1940); *Taylor v. State,* 29 Wn.2d 638, 188 P.2d 671 (1948).

The issue of federal supremacy that appellees cite *O'Brien* for in the labor field was settled in the anti-trust field long ago by the Supreme Court in holding that states could validly enact regulations concerning combinations of copyright holders. *Watson v. Buck,* 313 U.S. 387 (1941); *Marsh v. Buck,* 313 U.S. 406 (1941). For obvious reasons, however, appellees would rather that these cases not be cited or discussed, and declined to do so.

***Amalgamated Ass'n of Street Electric Ry. & Motor Coach Employees v. Wisconsin Employment Relations Board,* 340 U.S. 383 (1951)**

This case is almost identical to the *O'Brien* case, above, dealing with the federal supremacy of the National Labor Relations Act over a state statute that directly conflicted with it. Regarding the right to strike, ". . . Wisconsin seeks to abrogate that right altogether

insofar as petitions are concerned." The statute would have altered the federal procedures of collective bargaining, and declared certain matters to be outside the scope of collective bargaining that the federal act required to be subject to collective bargaining.

***Interstate Hotel Co. of Nebraska v. Remick Music Corp.*, 157 F.2d 744 (8th Cir. 1946), cert. denied, 329 U.S. 809 (1947)**

Although the quotation set forth from this case in appellee's brief would appear to be quite favorable when read out of context, a reading of the entire case demonstrates its lack of application. This is primarily so because Ascap was not involved at all. If it weren't for Ascap's total dominance in the case presently before the Court there would be no case at all here either. Thus in *Remick* the Court said:

> "The answer to this contention is that the Society is not a party to the present suit, has no interest in the copyrights infringed [even the performance rights] and has not engaged in the transaction of any business in the State of Nebraska at any time material to the issues here." 157 F.2d at 474.

***Leo Feist, Inc. v. Demarie*, 16 F.Supp. 827 (W.D. La. 1935)**

This case is again quoted quite out of context and without stating the applicable facts. It involved an infringement suit against a dance hall. Louisiana had a statute that did not deal with infringements at all, but only with royalties. The Court held the statute in no way applicable to the case and expressly did not consider the constitutionality of the act.

> "Had the plaintiffs sought to exact the payment of royalties or rentals as a condition of permitting performance of the copyrighted compositions, or demanded therefor as such, then the case might fall within the language of the statute, except for the fact that it applies where such demands are made on copyrighted music books, recorded music for mechanical reproduction, or radio programs, none of which are involved in this instance." 16 F.Supp. at 828.

And at page 828:

> "I am also of the opinion that the statute cannot apply to this case, which was filed in 1933, long before the act of the legislature was passed, for it will not be presumed that it was intended to operate retroactively."

***Leo Feist, Inc., v. Young*, 138 F.2d 972 (7th Cir. 1943)**

Here again appellee's brief quotes out of context. Earlier in appellee's brief they admit that the Washington statute is a police power statute, not merely a revenue raising statute.

> "We are dealing, after all, with an anti-monopoly statute—19.24.060 subjects the music business to the police power of the state . . ." (Appellees' Brief, p. 28.)

As pointed out in the opening brief of appellant, pages 102-103, the Wisconsin statute was held not to be a defense because the statute was a licensing statute ". . . not relevant or material to the issue presented by the complaint" (138 F.2d at 976). If the Wisconsin statute had not been only a revenue raising statute,

". . . collateral to the cause of action and certainly not directly related to it . . ." the Court would have held its noncompliance by the plaintiffs as a valid defense to the infringement action.

***Shenandoah Valley Broadcasting, Inc., v. Ascap*, 331 F.2d 117 (2d Cir. 1964), cert. denied, 377 U.S. 997 (1964)**

The *Shenandoah* case is cited by appellees apparently to establish that the consent decree was again amended in 1950 to alleviate some of the problems of the consent decree. All the *Shenandoah* case does is emphasize the inequities of the Amended Final Judgment of 1950. It was amended in 1950 to correct the abuses Ascap had been perpetrating in the movie industry as brought out in the *Alden-Rochelle* and *Witmark* cases. The 1950 amendment did solve the movie industry problems by forbidding Ascap to be involved and let the competitive market place determine the price and distribution methods of music.

It was in the *Shenandoah* case that broadcasters attempted to petition Judge Ryan for relief from the abuses of the 1950 Amended Final Judgment. The Second Circuit recognized that broadcasters do not have the same advantages enjoyed by others such as the movie industry and the networks:

> "The provisions of Section V(A) and (B) requiring Ascap to license networks and producers in a manner that will relieve their members and customers of the need of obtaining separate licenses seem to have been designed for the benefit of the

> networks and the producers, not for that of the television stations, whose rights are specified in Section VII." 331 F.2d at 123.

And the Court concluded on page 124 by holding that broadcasters had no standing to request an amendment to the consent decree, and that if they wanted relief it would have to be in the Courts in an anti-trust action:

> "If appellants' position in fact has the merit under the anti-trust laws which they assert, they have effective remedies available, either by persuading the Department of Justice to apply under Section XVII for a modification of the judgment, or by a private suit which our ruling here in no way affects."

The only way an anti-trust case testing the validity of infringement suits as against copyright and anti-trust abuses can take place is for someone to infringe, wait for the infringement suit, assert the abuses as a defense, and counter-claim for injunctive relief and damages. That is what appellant has done. But, by infringing and bringing the matter to litigation, it is called a pirate and unworthy of equitable relief.

***Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173 (1942)**

The *Sola* case is another case dealing with the federal supremacy issue which appellant does not question in the slightest. It is just that the case is not germane to the issues here. However, the case is one dealing with price-fixing in a patent case. The Court held that a local rule of estoppel could not prevent the all-important operation of the policy of the anti-trust laws, and held

hat the defendant-licensee *could* assert as a defense to
suit on the license that it included a price-fixing clause
n violation of the anti-trust laws, and contrary rules,

> ". . . must yield to the Act's declaration that such agreements are unlawful, and to the public policy of the [Sherman] Act which in the public interest precludes the enforcement of such unlawful agreements. Cf. *Morton Salt Co. v. G. S. Suppigger Co.*, 314 U.S. 488, 492, 493, 86 L.ed. 363, 365, 366, 62 S. Ct. 402." 317 U.S. at 177.

APPENDIX B

Since the judgment was entered by the trial court, Ascap has threatened appellant, through counsel, that if appellant does not take a license retroactive to 1959 it will be sued for additional infringements amounting to thousands and thousands of dollars. Therefore, appellant applied for a current license.

However, if appellant pays fees to Ascap, it will, of course, be in violation of the Washington law. And, if it wins this litigation, it should be entitled to three times that sum of money in anti-trust damages. The trouble is that Ascap, being a non-profit association, will have distributed the money on a formula that is set up so that it is impossible to trace to the Ascap individual members, and would be nearly impossible for appellant to recover.

To remedy this dilemma of possibly throwing money away, and in violation of the Washington law at the same time, appellant has offered Ascap's counsel to place the money in trust or escrow in a bank, and even in the court registry. Whoever prevailed in the litigation would get the money, and in the meantime appellant would not be violating the Washington law. The check has been written and is being held by counsel.

To date Ascap and appellees have refused to issue appellant a license unless appellant pays all back fees, from January 1, 1959, to the present, directly to Ascap in cash. Lacking the money, Ascap threatens more litigation. As usual, the threats and intimidations have pre-

vailed and, as before mentioned, appellant has at this writing drawn a check to pay Ascap in cash over $26,000 in fees, much of which is payment for music appellant does not need or want.

No. 20074

IN THE

United States Court of Appeals For the Ninth Circuit

K-91, Inc.,
Appellant,

v.

Gershwin Publishing Corporation, et al.,
Appellees.

Appeal from the United States District Court for the Western District of Washington, Northern Division

Honorable Gus J. Solomon, *Chief Judge*

REPLY BRIEF OF APPELLANT

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METROPOLITAN PRESS SEATTLE, WASHINGTON

SUBJECT INDEX

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REPLY BRIEF OF APPELLANT

SUMMARY OF APPELLANT'S REPLY ARGUMENT

After reading appellees' answering brief we have again searched it for case authority. We have, for all practical purposes, found none. Those few cited are analyzed in Appendix A. Appellant challenged appellees to distinguish the cases cited by appellant. But, presumably because appellees could not meet the challenge, they ignore the cases entirely.

Similarly, appellees almost entirely ignore making any reference to the record below. Rather, they refer repeatedly to the trial court's findings and conclusions.

It is these findings and conclusions from which appellant is appealing. As appellant demonstrated in its opening brief, the trial court's findings and conclusions in this type of proceeding carry practically no weight at the appellate level (Appellant's Brief, p. 34). For recent authority in an anti-trust case squarely in point see *Associated Press v. Taft-Ingalls Corporation,* 340 F.2d 753 (6th Cir. 1965), at page 765:

> "It is our obligation as an appellate court to overrule the 'clearly erroneous' findings of the district court in an anti-trust case, as in other civil actions tried by a district judge without a jury."

Appellees acquiesce in this, but repeatedly assert in effect that the trial court's findings are sustained because the trial court found them and that proves them. This reply brief will not just repeat appellant's previous arguments. They have been set forth and gone unanswered. Appellant will reply to appellees' arguments but without much additional reference to the cases or record because these are adequately supplied in appellant's brief.

VIOLATIONS OF WASHINGTON STATE STATUTES

The Power of States to Regulate Pooling of Copyrights

Appellant in its opening brief reviewed Ascap's own extensive litigation on the exact issue of state power to legislate in the area of musical copyright combinations (appellant's brief, 15-17). Appellee declined to even mention these cases, let alone analyze them, and cites such remote cases as labor disputes. Those cases are reviewed in Appendix A herein. We can only assume

that, like the federal anti-trust cases, appellees cannot distinguish them, and so ignore them.

Appellees' Arguments That Per Program Licenses Are Really Per Piece

Appellees contend that they satisfy the per piece requirements of the Washington law because of the Ascap per program license. They say that, for some unexplained reason, it would be difficult to establish a price for each piece of music. They make this contention without the basis of *any* evidence whatsoever. The *only* evidence, coming from several witnesses, was that it would be quite feasible to list the price of music. This evidence is set forth in appellant's opening brief in Appendix H. In *U. S. v. Loew's, Inc.*, 371 U.S. 38, 9 L.Ed.2d 11 (1962), the Supreme Court rejected the identical argument and demanded that each film be quoted at a set price.

Appellees relate that the same price should not be charged for "A La Cubana" as for "Easter Parade." That is precisely our point. The price should be on a per piece or per play basis as the Washington legislature demanded—not on gross. When the consumer buys a phonograph record from the record store he pays various prices for various records—competitively—as it should be. The same should be true for performance rights. In order to buy a phonograph record the consuming public doesn't have to pay 8 per cent of its gross income regardless of which record is purchased. But, under the Ascap per program license, if a broadcaster grosses $50

for a one-hour program in which one record is played, he must pay $4 (8 per cent of his gross) whether the record is "A La Cubana" or "Easter Parade." Or whether 30 seconds of music is played or 59 minutes.

It was obviously this precise evil which the Washington legislature had in mind when it outlawed blanket licenses per se. It then went on to require per piece licenses *as a condition* to allowing composers to pool their performance rights. (RCW 19.24.020) *But it did not make blanket licenses legal.*

Appellees admit that Ascap uses blanket licenses in Washington. Thus they are violating RCW 19.24.020 without regard to the question of whether a per program license is "per piece."

Appellees argue that the Washington legislature must have meant per program when it said "per piece." The Washington legislature said just what it intended to say, "per piece." If it had intended to say "per program" it would have. Even in 1937 we can assume the legislature knew the difference between a piece of music and a radio program. Some of the most popular radio *programs* of the general era were made up of several *pieces*, e.g., The Hit Parade, The Fred Waring Program, The Telephone Hour.

The legislature expressly *defined* what it intended by the phrase "per piece" as being ". . . so much money per each time a piece of music is played or used in a public performance for profit" (RCW 19.24.140).

Appellees also contend that per program licenses should be construed to be per piece licenses within the meaning of the Washington law because the Amended Final Judgment requires Ascap to issue a per program license. Apparently appellee thinks that when a defendant (Ascap) is caught violating the federal anti-trust laws and enters into an agreed order, that comity requires a different interpretation of a state law—some kind of retroactive legislation by two non-legislative groups located in the state of New York. The consent decree was entered in 1941, four years after the Washington law was enacted.

Although appellees keep stating that the Amended Final Judgment is everyone's delight, the simple fact is that only the U. S. Justice Department and Ascap's management have any standing to question its wisdom. Disenchanted rank and file members of Ascap have attempted to intervene, but the United States Supreme Court ruled it was a matter between only Ascap and the government and no one else has any voice in it. *Sam Fox Publishing Co. v. United States*, 366 U.S. 604 (1961). (Appellant's Brief 115-119.) When the All Industry Committee attempted to get different licenses from those provided in the consent decree, the broadcasters were told the same thing. *United States v. Ascap*, 331 F.2d 117 (2d Cir. 1964).

It is preposterous to argue that a decree which binds only Ascap, which no one else has any standing to contest, which is not even a law but a judgment, which can be and has been amended from time to time, has any-

thing whatever to do with the interpretation of a Washington statute. Are we to assume that each time that Ascap agrees to another amendment of the Amended Final Judgment that a 1937 Washington law is to have a different interpretation?

Appellees also contend that not only the state legislature meant to say "per program" instead of "per piece" in 1937, but that the legislature's legal advisor in 1962 was wrong when he issued an opinion to a state senator that the Ascap per program license was another form of blanket license and therefore illegal (Def. Ex. A-14). In so doing, appellees will have to include Ascap's own chief attorney who testified *under oath* before Congress on at least two occasions that the per program license was only another form of blanket license. (Testimony quoted at page 45, Appellant's Brief.)

Finally, appellees contend that they comply with the Washington statute because all members of Ascap under the Amended Final Judgment are free to deal separately. It is a stipulated fact that this is *an impossible alternative* (R. 30, Agreed Fact 50, pp. 10-11). Even if it were possible in Washington, the members do not offer licenses individually.

It is again a *stipulated fact* that the *only* licenses made available are those contained in the files of the Washington Secretary of State (R. 30, Agreed Fact 25 and 28, p. 6). The *only* licenses filed there are the per program and blanket licenses as far as the broadcasters are concerned. There are per piece licenses available to every

other user of music in Washington (Def. Ex. 7, 8, 8-A, Schedule 11), but broadcasters are *expressly excluded.* As previously pointed out, no other users of music are licensed in the State of Washington or pay any fees whatsoever (R. 30, Agreed Fact 21, p. 5).

Appellees even admit in their brief that the only licenses made available by the individual Ascap members to broadcasters are the "per program" and "blanket" licenses when they say any filing the members might make with the Secretary of State would be a duplicate of the filing made by Ascap for its members (Appellant's Brief, p. 25).

Notwithstanding the terms of the Amended Final Judgment, in Washington the individual members of Ascap do not make individual licenses available. As to the rest of the United States, the assertion that they stand ready to deal is an empty platitude. *The fact is that there are no such licenses in existence* (R. 30, Agreed Fact 60, p. 11).

The 1959 Proceedings Before Judge Ryan

Appellees state that the most important single fact in this case was the 1959 proceedings before Judge Ryan. Appellant fails to see that it is of much significance at all. Appellant was not even a party. However, since appellees find it so all-important, appellant feels compelled to comment.

As usual, rather than cite what the facts are, appellees cite the trial court's interpretation. They quote the trial

court's finding that in 1959 Judge Ryan ruled that, in the circumstances presented, Ascap would not be required to issue licenses in Washington. The *stipulated facts* (R. 30, Agreed Fact 73, p. 13) and Judge Ryan's order recites (Pl. Ex. 12) that, when the Washington broadcasters applied to that court for a reasonable license fee pursuant to Section IX, Ascap *refused* to issue them any licenses whatsoever. Not only the petitioners were refused a license, but everyone else in the whole state —even those broadcasters that appellees admit have faithfully paid tribute to Ascap over many years.

Appellees repeatedly assert that appellant had at all times the right to apply for a blanket or per program license under the Amended Final Judgment. For the many reasons related in appellant's two briefs it, of course, declined to do so. (See *Hazeltine Research, Inc. v. Zenith Radio Corporation,* 239 F. Supp. 51 (1965) at 72, where the court holds that one may properly refuse to take a license when the alternatives are coercive.) Now, add to those facts the 1959 proceedings and we find that when an application was made, Ascap demonstrated its immense power by refusing *anyone* licenses, subjecting all users of music to possible damages of up to $5,000 per performance. If the 1959 proceedings are important at all, *those* are the reasons, not what Judge Ryan thought about the effect of the Washington law in an order submitted to him under great distress and intimidation.

If Ascap was guided by the 1948 Attorney General's opinion, as appellee asserts, and the trial court "found,"

why did Ascap pull all of its music out of Washington in 1959—even as to broadcasters who religiously paid? Why has it never licensed any other music user in this state?

Since appellees make such an issue out of appellant's failure to pay Ascap even now, may we remind appellees that that is exactly what this litigation concerns. (Again, see *Hazeltine Research, Inc., v. Zenith Radio Corp., supra.*) The damages in this suit come to less than the cost of printing appellant's two briefs. What is important to appellant is that broadcast music be freed for competitive pricing as was done in *Alden-Rochelle v. ASCAP*, 80 F. Supp. 888 (S.D. N.Y. 1948), for movie performances. (Since appellees went off the record to inform the Court as to appellant's present status of license payments, appellant has taken the liberty of completing the story in Appendix B.)

One more critical factor bears on the importance of the 1959 order to the present case. That order only approves the forms of licenses that were attached to the order. The licenses affixed to the order provide by their own terms that they must be construed under the laws of *New York* (Pl. Ex. 12, 6; Def. Ex. 7). Relying on this, in the Washington State Superior Court action in Yakima, Washington, *Cascade Broadcasting Co. v. Ascap*, Cause No. 45877, Ascap contended that the licenses signed by Cascade Broadcasting Co. (a 1959 petitioner) should be construed under the laws of New York rather than the laws of Washington. The Washington court properly held, however, that

> ". . . the laws and decisions of the State of Washington are applicable to the agreements between the parties any provisions in said agreements notwithstanding." *Cascade Broadcasting Co. v. Ascap*, Superior Court Cause No. 45877, County of Yakima, Washington.

The court relied on *Carsten Packing Company v. So. Pac. Ry.*, 58 Wash. 239, 108 Pac. 613 (1910), that parties may not circumscribe the public policy of a state by conveniently agreeing that another state's laws apply. Therefore, the Washington courts have made the 1959 order a nullity because the licenses approved by the order *must* be construed under Washington laws and *not* under New York laws as Ascap might like.

Lastly, how appellees can say no Washington official has criticized Ascap's filings is puzzling, to say the least, in view of the Attorney General's opinion of 1962 that the per program was really a form of blanket license and illegal, making the only two licenses offered in Washington illegal (Def. Ex. A-14).

Appellees find comfort in the fact that neither they, nor Ascap, or Washington broadcasters who deal with Ascap, have been prosecuted. We assume they found the same comfort between the original Final Judgment in Civil Action No. 13-95 when the Justice Department took no further action until the *Alden-Rochelle* cases and *M. Witmark & Sons v. Jensen*, 80 F. Supp. 843 (D. Minn. 1948), in which Ascap was found to be guilty of antitrust and copyright abuses in nearly every aspect of Ascap's operation despite the 1941 decree. The Justice

Department did not move in on Ascap, just as it does not now, and just as Washington officials have declined to do. But that doesn't make it right or legal, as *Alden-Rochelle* and *Witmark* so amply demonstrate. More important, the argument that failure to prosecute is persuasive of anything at all in the present case is not worth further comment. If public prosecutors were infallible, Congress would not have provided for private rights of action in the anti-trust law.

THE AMENDED FINAL JUDGMENT

Appellees' central argument on the federal issues of anti-trust violations and abuse of their copyrights is to ignore the cases appellant cites and hide behind the consent decree. Their main thrust is that the high-sounding words of the consent decree guarantee competition and fair play for all. All users of music, they keep saying, are guaranteed equal treatment and protection.

Then may we ask why—if the consent decree guarantees all of these things—broadcasters in the United States pay more than 87 per cent of Ascap's total revenues and less than 13 per cent (R. 30, Fact 48, p. 9) is paid by all other users combined, which include all bars, grills, taverns, night clubs, restaurants, seasonal resorts, lounges, occasional or one night bands, dance halls, roller skating rinks, ice skating rinks, rodeos, wrestling, ice hockey, roller derbies, walkathons, professional football and basketball, fashion shows, wired and recorded music not cleared at the source, dog tracks, horse tracks, amusement parks, carnivals, music in industry,

circuses, sound trucks, home shows, expositions, picnic groves, boats, popular concerts, extravaganzas, western revues, variety shows, railroad cars, department stores, hotels, ballrooms and symphonies. (These are among the separate Ascap licenses filed with the Washington Secretary of State, Def. Ex. 7, 8). *In the State of Washington all combined pay zero.*

Even within the broadcasters the consent decree falls far short of providing any so-called equal treatment. Why, for example, can Ascap hire lawyers, monitors, etc., and bring infringement suits against 11 small radio stations as they did in these proceedings, and not even bother big network affiliated radio and TV stations? For just one example, KVOS-TV, a CBS network affiliate, wasn't sued, and is not licensed (R. 31, Admission Nos. 8, 9, 10). CBS owns Columbia Records, Inc., one of the largest recording companies in the United States (R. 31, Admissions Nos. 12, 13).

Why is it the networks, movie exhibitors, background music users, jingles, etc., are cleared at the source, but not broadcasters? The answer to why these and the other flagrant abuses previously related exist is because Ascap was formed in 1914 before broadcasting came into existence.

The broadcasters were not a party to the consent decree, were not consulted when it was entered, and cannot request that it be amended. *U.S. v. Ascap,* 331 F.2d 117 (2d Cir. 1964). When the government and Ascap entered into the decree the government did not

protect the broadcasters. Just as the *Alden-Rochelle* and *Witmark* cases proved it had not protected the movie industry.

Even though Ascap had "only" the non-exclusive license rights it still has today, the movie industry prevailed in the *Alden-Rochelle* and *Witmark* cases. Appellees say those cases are only of historical interest because the *Alden-Rochelle* decree was vacated. Of course it was—after the consent decree was amended in 1950 to conform to the findings of the court. It prohibited Ascap from ever "collecting any monies from, or negotiating with any motion picture theatre exhibitor . . ." (Para. IV. E). It compelled clearance at the source, which is done on a competitive basis, rather than the old abuse of licensing on gross receipts or number of seats. The theatre owner still pays Ascap, but by purchasing a competitively priced film, which he can take or leave on price alone. It wasn't the consent decree that produced this right. It was anti-trust litigation, just like this action, and which the broadcasters were expressly invited to bring by the Second Circuit Court of Appeals. *United States v. Ascap*, 331 F.2d 117 (1964). As the Supreme Court said about the consent decree, private litigants simply are "not bound by government litigation." *Sam Fox Publishing Co. v. U.S.*, 366 U.S. 604 (1961).

The consent decree has not changed much of anything for the broadcasters. Prior to 1941, Ascap charged broadcasters a percentage of their gross under a blanket license. Out of the over 5,000 radio stations, over 98

per cent are still paying on a blanket license on a percentage of their gross. What has changed? The "per program" license is window dressing. Their attempts to amend the decree have failed.

The whole concept of the consent decree is wrong. It substitutes a fantastically cumbersome procedural process that, for the average broadcaster, has accomplished nothing. The alternatives as stipulated are impossible.

For broadcast performance rights there has *never* been competition. What Congress feared when it passed the Copyright Act of 1909 happened just five years later when Ascap was formed in 1914. Copyrights were compounded one on the other and the pooled combination came into being.

The trial court missed the whole point in supposedly "balancing the equities" and finding no other system would work. The reason another system has not worked is because the consent decree will not allow a natural system to evolve. The Justice Department and Ascap have been allowed to substitute their own judgment and now the trial judge has said he, too, knows what will or will not work, and what is best for the public.

The only way performance rights for radio and TV use can find their value—so that "Easter Parade" can be selected and its composer remunerated according to its worth, and "A La Cubana" find its deserving repose—is for this court to free the performing rights to the

music as Judge Leibell did in *Alden-Rochelle*.

As each new radio station comes on the airways to try to please its listeners, it finds itself with very few sponsors. It plays a great deal of music and has only a few commercials. Consequently, it pays Ascap relatively little. As the station builds an image and an audience, it has more commercials and plays less and less music. The *less* music it has time for, the *more* it pays for the music. This is the stigma of the consent decree.

We hope this court will give this station the opportunity to pay for only the music it needs, and to do its own bargaining for it, rather than the Justice Department, Ascap, or even a Federal Judge.

Finally, appellant cannot put it more strongly than to state that it defies the appellees—or anyone for that matter—to distinguish rationally the following cases and their rulings from the present case: *Associated Press v. Taft-Ingalls Corporation*, 340 F.2d 753 (6th Cir. 1965); *Hazeltine Research, Inc., v. Zenith Radio Corporation*, 291 F. Supp. 51 (N.D. Ill. 1965); *United States v. Loew's, Inc.*, 371 U.S. 38 (1962); *M. Witmark & Sons v. Jensen*, 80 F.Supp. 843 (D. Minn. 1948); *Alden-Rochelle, Inc., v. Ascap*, 80 F.Supp. 888 (S.D.N.Y. 1948).

The appellant did not cite the *Associated Press* case in its opening brief because appellant's counsel did not discover the case before the brief was printed. Appellant

submits that the case is exactly comparable to the present case on the anti-trust issues, just as the *Hazeltine* case is.

In the *AP* case the court, at page 756, summarized the issue of that case *and this one* thusly:

> "This AP policy and practice of 'tying' four wire services together in a single 'package' and requiring the appellant to take and pay for four wire services in order to receive any one of them is the principal issue on the appeal."

AP sued the subscriber newspaper for breach of contract for failure to pay fees for the AP news services. The newspaper, as in the present case, defended alleging violation of the anti-trust laws. The district court held for AP and awarded damages. The Circuit Court reversed, stating, at page 762:

> "Yet the record clearly established that AP required appellant to continue to subscribe and pay for three wires which appellant did not want and need, in order to receive a fourth wire which it considered essential, and thereby forced appellant to give up its independent judgment as to whether to subscribe to the three unwanted and unneeded services. This is one of the situations which is 'an object of anti-trust concern.' *United States v. Loew's, Inc., supra,* 371 U.S. 38, 44-45, 83 S. Ct. 97, 102."

The court further pointed out that the practice of packaging news services had been adhered to consistently by AP since 1935. The mere fact that no one challenged it for thirty years is inconsequential, contrary to what the appellees say.

Note that exact similarity of the cases. Ascap require broadcasters to subscribe to all of the compositions in

ts repertory in order for a station to receive any one of them. As the testimony at the trial showed and the stipulated facts established beyond question, the radio station KIXI needs and uses only a small number of carefully selected popular standards. It should not be forced by Ascap to give up its independent judgment and subscribe to unwanted and unneeded compositions such as rock and roll, country-western, or symphony. As before stated, appellant should not be required to allow Ascap, the appellees, the Justice Department or a federal judge to force it to take and pay for unwanted and in many cases inferior music.

Respectfully submitted,

Ronald A. Murphy
Attorney for Appellant
K-91, Inc

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

Ronald A. Murphy
Attorney for Appellant

APPENDIX A

***Alfred Bell & Co. v. Catalda Fine Arts, Inc.*, 191 F.2d 99 (2d Cir. 1951)**

Appellees cite this case for the proposition that a nominal or marginal violation of the anti-trust laws will be subordinated to the copyright privilege. A simple reading of that case will demonstrate that the Court found there was *no* violation of the anti-trust laws, that, in fact, nothing of any consequence regarding anti-trust matters even took place in the United States, that the defendants did not have this defense in mind when they infringed, and that it was not even originally alleged as a defense to the infringement action (Footnote 32, page 106).

Clearly the *Catalda* case has no applicability to this case, where the anti-trust aspects of the case were asserted and emphasized from beginning to end and are hardly marginal. In addition, even if there were no anti-trust aspects to the present case at all, appellant should prevail under the teachings of the many cases cited by appellant that the abuse of a copyright prevents further exploitation of it by successful infringement actions.

***Automobile Workers Union v. O'Brien*, 339 U.S. 454 (1950)**

This is a case dealing with the National Labor Relations Act and has absolutely no application to the present case. Appellant takes no issue whatsoever with its holding. The case involved a statute of the State of

Michigan that was held invalid because it directly "conflicts with the federal Act" in several respects, such as shortening the time for a strike notice from the federally required sixty days to twenty days, and requiring a majority authorization of the strike.

The case arose in the state courts to test the validity of the state act. When Ascap attempted to test the copyright Protection Act in the State of Washington, it was thrown out of court for having "unclean hands" on both occasions. *Buck v. Gallager*, 36 F.Supp. 405 (D. Wash. 1940); *Taylor v. State*, 29 Wn.2d 638, 188 P.2d 671 (1948).

The issue of federal supremacy that appellees cite *O'Brien* for in the labor field was settled in the anti-trust field long ago by the Supreme Court in holding that states could validly enact regulations concerning combinations of copyright holders. *Watson v. Buck*, 313 U.S. 387 (1941); *Marsh v. Buck*, 313 U.S. 406 (1941). For obvious reasons, however, appellees would rather that these cases not be cited or discussed, and declined to do so.

***Amalgamated Ass'n of Street Electric Ry. & Motor Coach Employees v. Wisconsin Employment Relations Board*, 340 U.S. 383 (1951)**

This case is almost identical to the *O'Brien* case above, dealing with the federal supremacy of the National Labor Relations Act over a state statute that directly conflicted with it. Regarding the right to strike ". . . Wisconsin seeks to abrogate that right altogether

nsofar as petitions are concerned." The statute would ave altered the federal procedures of collective bargaining, and declared certain matters to be outside the cope of collective bargaining that the federal act required to be subject to collective bargaining.

***nterstate Hotel Co. of Nebraska v. Remick Music Corp.*, 157 F.2d 744 (8th Cir. 1946), cert. denied, 329 U.S. 809 (1947)**

Although the quotation set forth from this case in ppellee's brief would appear to be quite favorable vhen read out of context, a reading of the entire case lemonstrates its lack of application. This is primarily o because Ascap was not involved at all. If it weren't or Ascap's total dominance in the case presently before he Court there would be no case at all here either. Thus in *Remick* the Court said:

> "The answer to this contention is that the Society is not a party to the present suit, has no interest in the copyrights infringed [even the performance rights] and has not engaged in the transaction of any business in the State of Nebraska at any time material to the issues here." 157 F.2d at 474.

***eo Feist, Inc. v. Demarie*, 16 F.Supp. 827 (W.D. La. 1935)**

This case is again quoted quite out of context and vithout stating the applicable facts. It involved an inringement suit against a dance hall. Louisiana had a tatute that did not deal with infringements at all, but only with royalties. The Court held the statute in no vay applicable to the case and expressly did not consider the constitutionality of the act.

"Had the plaintiffs sought to exact the payment of royalties or rentals as a condition of permitting performance of the copyrighted compositions, or demanded therefor as such, then the case might fall within the language of the statute, except for the fact that it applies where such demands are made on copyrighted music books, recorded music for mechanical reproduction, or radio programs, none of which are involved in this instance." 16 F.Supp. at 828.

And at page 828:

"I am also of the opinion that the statute cannot apply to this case, which was filed in 1933, long before the act of the legislature was passed, for it will not be presumed that it was intended to operate retroactively."

***Leo Feist, Inc., v. Young,* 138 F.2d 972 (7th Cir. 1943)**

Here again appellee's brief quotes out of context Earlier in appellee's brief they admit that the Washing- ton statute is a police power statute, not merely a revenue raising statute.

"We are dealing, after all, with an anti-monopol statute—19.24.060 subjects the music business to th police power of the state . . ." (Appellees' Brief p. 28.)

As pointed out in the opening brief of appellant pages 102-103, the Wisconsin statute was held not t be a defense because the statute was a licensing statut ". . . not relevant or material to the issue presented b the complaint" (138 F.2d at 976). If the Wisconsi statute had not been only a revenue raising statut

". . . collateral to the cause of action and certainly not directly related to it . . ." the Court would have held its noncompliance by the plaintiffs as a valid defense to the infringement action.

***Shenandoah Valley Broadcasting, Inc., v. Ascap*, 331 F.2d 117 (2d Cir. 1964), cert. denied, 377 U.S. 997 (1964)**

The *Shenandoah* case is cited by appellees apparently to establish that the consent decree was again amended in 1950 to alleviate some of the problems of the consent decree. All the *Shenandoah* case does is emphasize the inequities of the Amended Final Judgment of 1950. It was amended in 1950 to correct the abuses Ascap had been perpetrating in the movie industry as brought out in the *Alden-Rochelle* and *Witmark* cases. The 1950 amendment did solve the movie industry problems by forbidding Ascap to be involved and let the competitive market place determine the price and distribution methods of music.

It was in the *Shenandoah* case that broadcasters attempted to petition Judge Ryan for relief from the abuses of the 1950 Amended Final Judgment. The Second Circuit recognized that broadcasters do not have the same advantages enjoyed by others such as the movie industry and the networks:

> "The provisions of Section V(A) and (B) requiring Ascap to license networks and producers in a manner that will relieve their members and customers of the need of obtaining separate licenses seem to have been designed for the benefit of the

> networks and the producers, not for that of the television stations, whose rights are specified in Section VII." 331 F.2d at 123.

And the Court concluded on page 124 by holding that broadcasters had no standing to request an amendment to the consent decree, and that if they wanted relief it would have to be in the Courts in an anti-trust action:

> "If appellants' position in fact has the merit under the anti-trust laws which they assert, they have effective remedies available, either by persuading the Department of Justice to apply under Section XVII for a modification of the judgment, or by a private suit which our ruling here in no way affects."

The only way an anti-trust case testing the validity of infringement suits as against copyright and anti-trust abuses can take place is for someone to infringe, wai for the infringement suit, assert the abuses as a defense and counter-claim for injunctive relief and damages That is what appellant has done. But, by infringing an bringing the matter to litigation, it is called a pirat and unworthy of equitable relief.

Sola Electric Co. v. Jefferson Electric Co., 317 U.S 173 (1942)

The *Sola* case is another case dealing with the federa supremacy issue which appellant does not question i the slightest. It is just that the case is not germane t the issues here. However, the case is one dealing wit price-fixing in a patent case. The Court held that a loca rule of estoppel could not prevent the all-importar operation of the policy of the anti-trust laws, and hel

that the defendant-licensee *could* assert as a defense to a suit on the license that it included a price-fixing clause in violation of the anti-trust laws, and contrary rules,

> ". . . must yield to the Act's declaration that such agreements are unlawful, and to the public policy of the [Sherman] Act which in the public interest precludes the enforcement of such unlawful agreements. Cf. *Morton Salt Co. v. G. S. Suppigger Co.*, 314 U.S. 488, 492, 493, 86 L.ed. 363, 365, 366, 62 S. Ct. 402." 317 U.S. at 177.

APPENDIX B

Since the judgment was entered by the trial court, Ascap has threatened appellant, through counsel, that if appellant does not take a license retroactive to 1959 it will be sued for additional infringements amounting to thousands and thousands of dollars. Therefore, appellant applied for a current license.

However, if appellant pays fees to Ascap, it will, of course, be in violation of the Washington law. And, if it wins this litigation, it should be entitled to three times that sum of money in anti-trust damages. The trouble is that Ascap, being a non-profit association, will have distributed the money on a formula that is set up so that it is impossible to trace to the Ascap individual members, and would be nearly impossible for appellant to recover.

To remedy this dilemma of possibly throwing mone away, and in violation of the Washington law at th same time, appellant has offered Ascap's counsel t place the money in trust or escrow in a bank, and eve in the court registry. Whoever prevailed in the litiga- tion would get the money, and in the meantime appe- lant would not be violating the Washington law. Th check has been written and is being held by counse

To date Ascap and appellees have refused to issue appellant a license unless appellant pays all back fees, from January 1, 1959, to the present, directly to Ascap in cash. Lacking the money, Ascap threatens more litiga- tion. As usual, the threats and intimidations have p-

ailed and, as before mentioned, appellant has at this
vriting drawn a check to pay Ascap in cash over $26,000
n fees, much of which is payment for music appellant
oes not need or want.

No. 20074

In the

United States Court of Appeals

For the Ninth Circuit

K-91, INC.,

Appellant,

v.

GERSHWIN PUBLISHING CORPORATION, et al.,

Appellees.

Appeal from the United States District Court for the Western District of Washington, Northern Division

Honorable Gus J. Solomon, *Chief Judge*

APPELLEES' BRIEF

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October 11, 1965.

INDEX

CITATIONS

No. 20074

IN THE

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K-91, INC.,
Appellant,
v.

GERSHWIN PUBLISHING CORPORATION, ET AL.,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

HONORABLE GUS J. SOLOMON, *Chief Judge*

APPELLEES' BRIEF

Jurisdictional Statement

This is an action for copyright infringement which appellees commenced in the United States District Court for the Western District of Washington, Northern Division (R. 1).* Appellees are the copyright proprietors of

*"R." refers to documents in the record on appeal as listed in appellant's designation of the record on appeal and appellees' counter-designation. "Tr." refers to pages in the trial transcript. "P. Ex." refers to plaintiffs' (appellees') exhibits. "D. Ex." refers to defendant's (appellant's) exhibits.

Judge Solomon's opinion and his findings of fact and conclusions of law are set forth in Appendix A to our brief. "App. A" refers to pages of said appendix.

four musical compositions. By this action, they sought to enforce their rights under the copyright laws of the United States—to recover damages for infringement of their copyrighted works and to enjoin further infringements, 17 U. S. C. §§ 1, 101, 116 (R. 1).

The trial court had jurisdiction over appellees' claims pursuant to 28 U. S. C. § 1338.

Appellant is the owner and operator of radio station KIXI in Seattle, Washington. Appellant's answer in the court below asserted defenses and a counterclaim under the federal antitrust laws (R. 4). The trial court had jurisdiction over appellant's counterclaim pursuant to 28 U. S. C. § 1337.

Appellant now appeals from a final judgment rendered by the trial court (Solomon, J.) granting appellees the relief they sought (R. 11). This Court has jurisdiction of the appeal by virtue of 28 U. S. C. §1291.

Statement of the Case

Introduction

Appellant's statement of the facts contains many errors and large amounts of irrelevant material. It becomes necessary, therefore, to state the relevant facts, as stipulated by the parties before trial (R. 30) and as found by the trial court based on the testimony and exhibits introduced at the trial (R. 37).

To begin, it is important to place in its proper perspective appellant's conduct which gave rise to this lawsuit. Appellant admits that it performed appellees' copyrighted musical compositions on its radio station (R. 30, Fact 5). Appellant admits also that the performances were public and for profit, and were made without payment of any royalty and without the consent of appellees (R. 30, Fact 6). Indeed, the trial court found that appellant has

regularly broadcast the musical compositions of appellees and of other authors, composers and publishers over its radio station, for profit, without the consent of the copyright owner or any licensing agency and without the payment of any royalty or compensation of any kind to any person (App. A, p. 9, Fact 8).

This was done, the trial court found, "pursuant to deliberate policy, long persisted in, and without any regard to the rights of plaintiffs and other copyright proprietors under the federal copyright law" (App. A, p. 9, Fact 9). Nor could appellant plead ignorance of the clear requirement of law that it pay for the use of copyrighted music; its station was managed by persons of considerable experience and wide knowledge of radio broadcasting (App. A, p. 9, Fact 9, Tr. 3).

These facts permit no conclusion but that appellant was a deliberate and wilful infringer. The Court below so found (App. A, pp. 2-6, 9, Fact 9), and its finding is not here challenged.

Accordingly, all that remains for consideration on this appeal is the sufficiency of the affirmative defenses urged by appellant as justification for its appropriation of appellees' property. These defenses, however denominated, boil down to two:

1. Appellant contends that appellees, together with the American Society of Composers, Authors and Publishers (ASCAP), an unincorporated membership association to which each appellee belongs, have violated a state statute, Chapter 19.24, Revised Code of Washington, the so-called Copyright Protection Law, and are therefore barred from maintaining this action;

2. Appellant contends that appellees, together with ASCAP, have violated the federal antitrust laws in the

use of their copyrights and are therefore barred from maintaining this action.

At the trial of this action, it was abundantly demonstrated that there was no merit in appellant's affirmative defenses—neither factually nor legally.

The District Court so held. There is no reason in law or in the facts here of record for this Court to disturb the result reached below.

The Decision Below

This action was consolidated for trial together with five other infringement actions commenced by appellees and other copyright proprietors against two other radio broadcasting corporations in Washington and the president and principal stockholder of one of them. The actions were tried before the Honorable Gus J. Solomon, Chief Judge of the United States District Court for the District of Oregon, sitting in these cases pursuant to designation by the district court judges in Washington.

After studying the statement of admitted facts, the evidence adduced at the trial, the exhibits and the memoranda of authorities submitted by the parties, the Court below concluded that appellees and the other plaintiffs below were entitled to prevail (App. A, pp. 2-6).*

As we have seen, Judge Solomon began by finding wilful and intentional infringement: the defendant broadcasters had deliberately and knowingly appropriated the property of appellees and thousands of other copyright proprietors.

With regard to appellant's affirmative defenses founded on Washington law, Judge Solomon wrote (App. A, p. 4):

---

*No appeals were taken in the other five actions.

> "I find that plaintiffs have complied with the statutory requirements of the State of Washington. Defendants have failed to prove that ASCAP's registration of the songs in its repertory was inadequate or that plaintiffs or ASCAP violated the Washington law relating to the pooling of copyright interests without providing for per piece licensing (RCWA 19.24.020); or that the filing of these and other actions by the plaintiffs to enforce their rights under the copyright laws constituted an abuse of either State or Federal process. There is no evidence of any abusive practices by either the plaintiffs or their licensing agent which would deny them copyright protection."

Judge Solomon also concluded that (App. A, p. 5):

> "To construe the provisions of the Washington statute (RCWA, Chapter 19.24) so as to make the acts of the plaintiffs or ASCAP in this case unlawful would raise grave questions concerning the constitutionality of the Washington statute under the Fourteenth Amendment to the Constitution of the United States."

With regard to appellees' alleged violations of the federal antitrust laws, Judge Solomon concluded that (App. A, p. 5):

> "Plaintiffs have not unlawfully extended their copyright monopolies through a combination among themselves or with ASCAP, nor are they guilty of violating the federal antitrust laws in any respect alleged by the defendants."

Although Judge Solomon found that appellant had deliberately appropriated appellees' property and had greatly

profited by its wrongful conduct, he fixed damages against appellant at the statutory minimum of $250 per infringement (App. A, p. 33, Conclusion 20).

Judge Solomon found also that plaintiffs below were entitled to reasonable attorneys' fees in the amount of $15,000, to be allocated among the six cases tried in accordance with the amount of statutory damages allowed in each case (App. A, p. 33, Conclusion 21). Accordingly, judgment was entered in this action for $1,000, plus attorneys' fees in the amount of $252.31 (R. 11).

Statutes Involved

The Copyright Law

Section 1 of the Copyright Law, 17 U. S. C. § 1, provides in pertinent part:

> "§ 1. Exclusive rights as to copyrighted works
>
> Any person entitled thereto, upon complying with the provisions of this title, shall have the exclusive right:
>
> * * *
>
> (e) To perform the copyrighted work publicly for profit if it be a musical composition; . . ."

Section 101 of the Copyright Law, 17 U. S. C. § 101, provides in pertinent part:

> "§ 101. Infringement
>
> If any person shall infringe the copyright in any work protected under the copyright laws of the United States such person shall be liable:
>
> (a) Injunction.—To an injunction restraining such infringement;
>
> (b) Damages and profits; amount; other remedies.—To pay to the copyright proprietor such

damages as the copyright proprietor may have suffered due to the infringement, * * * or in lieu of actual damages and profits, such damages as to the court shall appear to be just, and in assessing such damages the court may, in its discretion, allow the amounts as hereinafter stated, * * * and such damages shall in no . . . case exceed the sum of $5,000 nor be less than the sum of $250, and shall not be regarded as a penalty."

Section 116 of the Copyright Law, 17 U. S. C. § 116, provides:

"§ 116. Costs; attorney's fees

In all actions, suits, or proceedings under this title, except when brought by or against the United States or any officer thereof, full costs shall be allowed, and the court may award to the prevailing party a reasonable attorney's fee as part of the costs."

The Sherman Act

Section 1 of the Sherman Act, 15 U. S. C. § 1, provides in pertinent part:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ."

Washington Statute*

Section 19.24.010, R. C. W., provides that it shall be unlawful for any person to cause to be publicly performed

*The complete text of the pertinent Washington statute is set out in Appendix B to our brief.

for profit any musical work copyrighted under the laws of the United States without the consent of the owner. (Appellant has, as we have seen, pursued a policy of constant violation of this statute.)

Section 19.24.020, R. C. W., provides that two or more copyright proprietors may not "pool their interests for the purpose of fixing the prices on the use" of their copyrighted works or for the purpose of collecting fees or issuing "blanket" licenses for the right to perform their works publicly. The statute contains an exception: *"Provided, however,* such persons may join together if they issue licenses on rates assessed on a per piece system of usage."

Sections 19.24.040, and 19.24.050 and 19.24.055, R. C. W., provide that two or more copyright proprietors who join together are required annually to file in the office of the Secretary of State of Washington "a complete catalogue of the titles of their claimed compositions" together with a "list of the prices charged" for their works.

Section 19.24.060, R. C. W., declares that the provisions of Chapter 19.24, R. C. W., "shall be administered by the courts and other officials of this state in a manner consistent with, in aid of, and never in conflict with the copyright laws of the United States . . . [and] shall at all times effectuate the enforcement, the true intent, and meaning of the United States copyright laws in order to prevent abuses from being practiced within this state . . . by any individual, corporation, or organizations who attempt to use the Federal courts as innocent instrumentalities in the furtherance of any systematic campaign or scheme designed to illegally fix prices for the commercial use of copyrighted works through the use of extortionate means and terrorizing practices based on threats of suits, and an abuse of both state and Federal process."

The Facts

The record here discloses the following:

The Appellees and ASCAP

Appellees and the other plaintiffs below—among them Richard Rodgers, Irving Berlin and the late Cole Porter—include some of the most talented and successful writers of popular music in the United States today.

The right of a copyright proprietor to be rewarded for public performances for profit of his musical compositions is a valuable and important right—not only to the copyright proprietor but, more importantly, to the public as a whole. For without the incentives which flow to copyright proprietors from the rights granted to them in the Copyright Law, the seemingly endless variety of melodies and lyrics which result from the creative efforts of composers and lyricists would soon stop. The framers of the Constitution recognized the public value of so encouraging creativity. The Copyright Clause empowers the Congress "To promote the Progress of . . . useful Arts by securing for limited Times to Authors . . . the exclusive Right to their respective Writings . . ." U. S. Const., Art. I, § 8.

Appellees are all members of ASCAP, an unincorporated membership association which is organized under the laws of the State of New York and has over 8,800 author, composer and publisher members who own copyrights in separate musical compositions (R. 30, Facts 10, 11).

Before the organization of ASCAP, there was no effective method by which individual writers and publishers of music could secure payment for the use of their copyrighted musical works in public performances for profit. The users of music were so numerous and widespread, and each instance of use so fleeting, that no individual writer or

publisher could take the measures necessary to negotiate licenses with them or to detect unauthorized uses and secure legal redress. Conversely, music users who wished to perform thousands of works each year without risk of infringement had no practical means of obtaining licenses from the owners of all those works.

As a means of solving the problems of both the copyright owners and the users of music, ASCAP was organized in 1914 as an unincorporated membership association representing both writers and publishers.

ASCAP's Relations with Its Members*

The relationship between ASCAP and its members is subject to both internal and external regulation. Internally, ASCAP and its members are governed by the ASCAP Articles of Association and by agreements executed by each member and by the Society, the "General Agreement" (D. Ex. A-5), and the "Television Agreement" (P. Ex. 10). But these internal arrangements are subordinate to, and in large measure superseded by, the extensive regulatory provisions of the Amended Final Judgment of March 14, 1950 (D. Ex. A-2), entered on consent in an antitrust action entitled *United States* v. *ASCAP,* Civil Action No. 13-95 (D. C. S. D. N. Y.), and the Order of January 7, 1960

*Appellant's brief at numerous places purports to comment on ASCAP's history, its past licensing practices and other matters. These comments are usually as inaccurate as they are irrelevant. For example, appellant's brief (p. 15) states that "because of continuing dissatisfaction among ASCAP's own members John C. McGeehan by order of the court having jurisdiction of the consent decree is examining the design and conduct of ASCAP's method of surveying performances." No citation to the record before this Court is offered —doubtless because there could be none, appellant having said nothing on the subject at the trial. Hence the statement here is irrelevant. It is equally untrue.

It would be pointless on this appeal to correct the numerous factual errors contained in appellant's brief. But by our failure to correct appellant's mis-statements, we do not mean to acquiesce in them.

(D. Ex. A-3), entered in the same action. The Amended Final Judgment and the Order are the decrees now in effect; they superseded an earlier judgment, entered on consent in 1941.

Pursuant to the terms and conditions of these various documents read together,* each member of ASCAP, including appellees, has granted to ASCAP only the *non-exclusive* right to license non-dramatic public performances for profit of all the compositions written, composed or published by such member during the term of his membership in ASCAP, and has received the right to share in the royalty distributions made by the Society.

Thus, appellant's assertion on p. 6 of its brief that each member of ASCAP assigns to ASCAP all his non-dramatic performing rights of his copyrighted musical compositions is simply not so: As we have just seen, each member of ASCAP remains absolutely free to license public performances of his musical compositions. And a would-be licensee is free to deal either with the individual copyright proprietor or with ASCAP.

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*The Court will note that in major respects the General Agreement and the Television Agreement are modified by the Amended Final Judgment of 1950. For example, the General Agreement (which was for the term 1941-1965 and was drawn up in 1940) provides on its face that the member "sells, assigns, transfers and sets over unto the Society . . . the right of public performance . . . in each musical work" of which the member is the copyright proprietor (D. Ex. A-5). But each copy of the General Agreement has had stamped upon its face language indicating that it is modified by and subject to the Amended Final Judgment. This latter document enjoins ASCAP from "Holding, acquiring, licensing, enforcing or negotiating concerning any rights in copyrighted musical compositions other than rights of public performance on a non-exclusive basis" (D. Ex. A-2, Sec. IV[A]). The Amended Final Judgment defines "right of public performance" as meaning "the right to perform a copyrighted musical composition publicly for profit in a non-dramatic manner" (D. Ex. A-2, Sec. II[B]). Hence, as a result of the Amended Final Judgment, ASCAP receives under the General Agreement only a non-exclusive right to license non-dramatic public performances for profit.

(Appellant's brief at several points (pp. 8,85) purports to discuss ASCAP's system for making royalty distributions to its members. Appellant's discussion is misleading and erroneous. And, of course, ASCAP's system of royalty distribution is wholly irrelevant to any issue in this case. The fact is, however, that the ASCAP royalty distribution system is regulated by the provisions of the Amended Final Judgment and the Order of January 7, 1960. In essence, royalty distributions are keyed to and are dependent upon an objective survey of the music actually played by radio and television broadcasters and other users. The ASCAP survey is supervised by the District Court in New York. Good music does not, as appellant suggests, subsidize bad music. To the contrary, the copyright proprietors of all music are rewarded commensurate with the popularity of their music as revealed by the objective survey.)

ASCAP's Licensing Activity

ASCAP licenses many thousands of users of music throughout the United States, ranging from the three national television networks to the local tavern which employs musicians for Saturday nights.

Most users want—and receive—the right to perform as often as they wish any of the more than one million musical compositions in ASCAP's repertory. One of the defendants below, for example, broadcasts 60,000 playings of musical compositions per year (App. A, p. 10, Fact 12).

Thus it may fairly be said that ASCAP performs a virtually indispensable service both for its members and for the users of the members' music. The court below found (App. A, p. 12, Fact 25):

> "The licensing of public performances for profit of copyrighted musical compositions by licensing organizations such as ASCAP is the only practical

> way by which copyright proprietors may exercise their federally-granted right to license non-dramatic performances of their copyrighted compositions. No single copyright proprietor could deal individually with all would-be users of his copyrighted compositions, and it would be impossible for him to police the use of his copyrighted songs. Equally, most broadcasters and other users of copyrighted music could not deal separately with the thousands of copyright proprietors whose music they perform."

ASCAP's licensing activity is regulated and controlled in virtually every detail by the Amended Final Judgment of March 14, 1950 (D. Ex. A-2).*

The central theme of the Amended Final Judgment is that it guarantees any user the right to perform ASCAP music and guarantees further that he will pay no more than a fair license fee.

Under Section IX of the Amended Final Judgment, when any would-be user of some or all of the compositions in the ASCAP repertory applies to ASCAP for a license, ASCAP is required to advise him of the fee which it deems reasonable for the license requested. The making of the application operates automatically to license the applicant. If the parties are unable to agree upon a reasonable fee, the applicant may apply to the United States District Court for the Southern District of New York for determination of a reasonable fee. In any such proceeding, the burden is on ASCAP to establish the reasonableness of the fee which it has requested.

Once a reasonable fee has been finally determined by the Court, ASCAP is required to offer a license at a comparable fee to all other applicants similarly situated who shall thereafter request a license of ASCAP (D. Ex. A-2,

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*The Amended Final Judgment of 1950 is set out in Appendix C to our brief.

Sec. IX[C]). And even without a Court order fixing a fair rate, ASCAP is forbidden at all times to discriminate "in license fees or other terms and conditions between licensees similarly situated" (D. Ex. A-2, Sec. IV [C]).

Thus, any would-be user of any part of ASCAP's repertory, including appellant, is guaranteed that he *can* use that music and that he will pay no more than a fair license fee. For he has an absolute right to be free of discrimination; he is assured of equal treatment.

And if a would-be user for any reason desires not to deal with ASCAP, he is free to negotiate individual licenses with individual copyright proprietors. For under the Amended Final Judgment, as we have seen, each individual member of ASCAP retains the right to license public performances for profit of his musical compositions, and ASCAP is forbidden to license individual compositions except upon specific written request of both the member and the user (D. Ex. A-2, Sec. VI).

Would-be users of ASCAP music have made extensive use of the provisions of Section IX of the Amended Final Judgment. In the past, whenever existing ASCAP licenses with radio or television broadcasters were about to expire, the broadcasters have joined together in industry-wide committees for the purpose of negotiating new terms with ASCAP (App. A, p. 14, Fact 30). On occasion, negotiations have been unsuccessful and the broadcasters have excercised the rights conferred by Section IX and commenced court proceedings for determination of a reasonable license fee (App. A, p. 14, Fact 30).

ASCAP's Washington Licensing

The Amended Final Judgment of course controls ASCAP's licensing activity with respect to broadcasting

of music in the State of Washington, just as it controls in the other forty-nine states—and broadcasters in the State of Washington, like broadcasters in the rest of the United States, have excercised the rights conferred by Section IX. Indeed, the only licenses ASCAP now issues to broadcasters in the State of Washington were the product of a recent Section IX proceeding. Accordingly, it is pertinent briefly to review that proceeding:

1. *The 1959 rate-fixing proceeding.* In the years before 1959, some Washington broadcasters refused to enter into license agreements with ASCAP; nor did they seek individual licenses from composers or publishers. This was, of course, their right. No broadcaster has any obligation to broadcast copyrighted music. If he broadcasts no copyrighted material, he needs no license. But these broadcasters wanted it both ways; they regularly broadcast copyrighted music and paid nothing to any copyright owner.

Other broadcasters, perhaps mindful of their obligations under federal law or basic principles of fairness, obtained licenses, paid license fees and so did not infringe.

In 1958, some of the broadcasters who had entered into agreements with ASCAP stopped paying fees on the alleged ground that payment would violate Ch. 19.24, R. C. W. (App. A, p. 21, Tr. 341).

ASCAP's agreements with broadcasters throughout the United States expired on December 31, 1958 (App. A, p. 21, Fact 39, Tr. 341). Early in 1959, a group of broadcasters from all over the country commenced a proceeding in the United States District Court for the Southern District of New York under Section IX of the Amended Final Judgment for determination of reasonable fees for licenses, effective as of January 1, 1959 (App. A, p. 21, Tr. 341). Included among the petitioning broadcasters were

eleven broadcasters located in the State of Washington (App. A, p. 21, Tr. 341).

In that proceeding, the Court ruled that, in the circumstances presented, ASCAP would not be required to issue licenses to any petitioning broadcaster in the State of Washington (App. A, p. 21, Tr. 341-342). Thereafter and until November 20, 1959, ASCAP did not offer licenses to Washington broadcasters (App. A, p. 21, Tr. 342).

In the interim, negotiations were had by ASCAP's general counsel, Herman Finkelstein, and Ronald A. Murphy, Esq., president and counsel of the Washington State Association of Broadcasters. (Mr. Murphy, is, of course, counsel to appellant in this case.)* And, on November 20, 1959, Mr. Murphy filed a petition in the United States District Court for the Southern District of New York on behalf of the owners of 61 Washington radio and 7 television stations (P. Ex. 11). The petitioners asked the Court to issue an order (P. Ex. 11)**

> "(a) directing ASCAP to grant to petitioners and others similarly situated who may join herein, licenses for the right of public performance of compositions in the ASCAP repertory by the radio and television stations operated by them within the State of Washington;
>
> "(b) determining and establishing the terms and conditions of such licenses."

At the request and consent of the petitioners, the Court (Ryan, C. J.) entered an order, on November 20, 1959, di-

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*It should be noted that in 1959, Mr. Murphy, on behalf of his then clients, consented to the entry of an order which found that ASCAP licenses with Washington broadcasters were lawful under Ch. 19.24 R. C. W. Now, on behalf of another client, he takes the position here that any broadcaster who signed such a license committed a criminal act punishable under Washington law.

**The petition is set out in Appendix D to our brief.

recting ASCAP to issue licenses to the petitioners in one of two specified forms for the period January 1, 1959 through December 31, 1963 (P. Ex. 12). Judge Ryan found (P. Ex. 12):*

> "6. Taking into consideration the provisions of the Amended Final Judgment herein, the regulation of the activities of the respondent thereunder and the scope of its activities pursuant thereto, and giving due regard to the enactment of Revised Code of Washington, C. 19.24—Laws of 1937, C. 218, the licenses which the Society is hereby directed to issue may lawfully be entered into between respondent and petitioners, and respondent is hereby directed to enter into such license agreements with each of the petitioners.
>
> "7. The provisions in said agreements for the disposition of claims for the period prior to June 1, 1959 are reasonable and do not discriminate against other users in the State of Washington or other states."

The two specified license forms were the so-called "blanket" and "per program" licenses (App. A, p. 22, Fact 45). In broad terms, both licenses grant the licensee the right to perform whatever ASCAP music he desires, whenever he desires. Under the blanket license, the fee charged is 2.125 % of the licensee's over-all revenues from sale of time on the air, after certain deductions (App. A, p. 22, Fact 45). Under the per program license, the licensee pays a higher percentage, but the fee is based only on the revenues from programs on which compositions in the ASCAP repertory are performed (App. A, p. 22, Fact 45).

---

*Judge Ryan's order is set out in Appendix E to our brief.

2. *Appellant's refusal to take a license.* Although appellant was not a petitioner in the 1959 rate-fixing proceeding, it knew what was going on (R. 30, Fact 75, App. A, p. 23, Fact 46).* From time to time during the negotiations

---

*The petitioners in the 1959 rate-fixing proceeding were:

KBKW Inc.	(KBKW)
KXRO Inc.	(KXRO)
Auburn Broadcasters Inc.	(KASY)
Bellevue Broadcasters	(KFKF)
KPUG Inc.	(KPUG)
Bremerton Broadcasting Co.	(KBRO)
Central Broadcasting Corp.	(KELA)
KITI Corp.	(KITI)
Lake Chelan Broadcasting Corp.	(KOZI)
Adrian Devries	(KCLX)
Colville Broadcasting Co.	(KCVL)
Western Broadcasters Inc.	(KXLE)
Coulee Broadcasting Corp.	(KULE)
Walter N. Nelskog	(KQTY)
Everett Broadcasting Co.	(KRKO)
Ralph A. Nachtmann	(KFDR)
James D. Higson	(KLOG)
KEPR Inc.	(KEPR)
Ferguson & Hall	(KFHA)
Triad Broadcasting Corp.	(KEDO)
KSEM Inc.	(KSEM)
Central Basin Broadcasting Corp.	(KWIQ)
Beckley Radio Co.	(KBRC)
Tom Olsen	(KGY)
KITN Corp.	(KITN)
KOMW Inc.	(KOMW)
KZUN Inc.	(KZUN)
Othello Radio	(KRSC)
KORD Inc.	(KORD)
KPKW Radio	(KPKW)
Radio Pacific Inc.	(KONP)
Prosser-Grandview Broadcasters Inc.	(KARY)
KOFE Inc.	(KOFE)
Wash. State University	(KWSC)
Quincy Valley Broadcasters	(KPOR)
Willapa Broadcasting Co.	(KAPA)
D & D Broadcasting Corp.	(KALE)
Wash. Telecasters Inc.	(KAYO)
KING Broadcasting Co.	(KING)

(Footnote Continued on following page)

between ASCAP and petitioners, and subsequent to November 20, 1959, Mr. Murphy, counsel for the petitioners, advised all Washington broadcasters of the opportunities provided by Judge Ryan's order (P. Ex. 13).

Appellant decided not to take advantage of the licenses made available under Judge Ryan's order (R. 30, Facts 76, 77, App. A, p. 23, Facts 47, 48). It preferred to continue to infringe.

The present action was brought to recover damages for four acts of infringement and to obtain injunctive relief against further use by appellant of appellees' property.

Appellant seeks to justify its refusal to take a license from ASCAP on the ground that it was apprehensive

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Queen City Broadcasting Co.	(KIRO)
Seattle Broadcasting Co.	(KOL)
Fisher's Blend Station Inc.	(KOMO)
KTIX Inc.	(KTIX)
Golden West Broadcasters	(KVI)
KXA Inc.	(KXA)
KHQ Inc.	(KHQ)
KLYK Inc.	(KLYK)
Northern Pacific Radio Corp.	(KXLY)
Cole E. Wylie	(KREW)
Tacoma Radio Corp.	(KMO)
Tacoma Broadcasters Inc.	(KTAC)
Tribune Publishing Co.	(KTNT)
Radio Broadcasters Inc.	(KENE)
Leader Broadcasting Co.	(KHIT)
Walla Walla Broadcasting Co.	(KTEL)
Frontier Broadcasting Co.	(KMEL)
KUEN Broadcasting Co.	(KUEN)
Cascade Broadcasting Co.	(KIMA)
KIT Inc.	(KIT)
Yakima Broadcasting Corp.	(KLOQ)
KREM Broadcasting Co.	(KREM)
Basin TV Co.	(KBAS-TV)
Cascade Broadcasting Co.	(KEPR-TV)
KHQ Inc.	(KHQ-TV)
KREM Broadcasting Co.	(KREM-TV)
Northern Pacific Television Corp.	(KXLY-TV)
J. Elroy McCaw	(KTVW)
Cascade Broadcasting Co.	(KIMA-TV)

of criminal prosecution under Washington law and because it had been advised by counsel and was of the "firm belief" that ASCAP and its members were misusing their copyrights in violation of federal law.

Judge Solomon, who heard and saw the witnesses offered by defendants below, made this finding of fact (App. A, p. 26, Fact 66):

> "Defendants' failure to take licenses from ASCAP was not because they feared prosecution under Chapter 19.24, R. C. W. Defendants failed to take licenses only because they wanted to avoid paying license fees on the same basis charged to—and paid by—other broadcasting companies."

The evidence fully supports Judge Solomon's finding. First, so far as fear of prosecution is concerned, no representative of appellant testified to any such fear. Indeed, no representative of appellant testified on any subject. And the testimony at the trial was all to the effect that none of the defendants below, nor any officer of any defendant corporation, had ever been threatened with prosecution under Ch. 19.24, R. C. W., from 1937 when the statute was first passed to the date of the trial (Tr. 182, 202, 252, 300). None of the defendants' witnesses had ever heard of any broadcaster who had been so threatened (Tr. 182, 202, 251-252, 300-303). These facts are particularly significant in light of the testimony at the trial that most Washington broadcasters have taken licenses from ASCAP and other licensing organizations and have publicly participated in judicial proceedings to obtain such licenses (Tr. 341-342). In short, the inference is inevitable that the public authorities of the State of Washington have been fully aware of the relations between Washington broadcasters and ASCAP and other licensing organizations and have

deliberately decided that ASCAP's activities require no correction.*

Appellant's claim with regard to its "firm belief" that ASCAP and its members were misusing their copyrights in violation of federal law is equally without merit. First, there is no testimony in the record here with regard to appellant's state of mind—as we noted above, no representative of appellant testified at the trial. Appellant's "firm belief" is thus a manifest afterthought. Second, even to the extent that there is any evidence in this record that *any* defendant below refused to take an ASCAP license because it believed ASCAP was violating federal law, that evidence is highly questionable and unworthy of belief. Defendant Rogan Jones, president of defendant International Good Music, Inc., admitted on the witness stand that he had taken ASCAP licenses for radio stations with which he was connected in states other than Washington and that he would not regard ASCAP's alleged violation of federal law as justification for his infringement (Tr. 299-300).

3. *Other infringers.* Appellant and the other defendants below were not the only infringers in the State of Washington. Other stations—including some which had been petitioners before Judge Ryan—also decided to infringe rather than pay the license fees which Judge Ryan had found to be fair and reasonable.

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*Since appellant has departed from the record to assert its fear of prosecution under Washington law, perhaps we may similarly depart to negate this claim of fear: After the judgments below were entered, appellant executed and tendered to ASCAP a retroactive license agreement covering the period January 1, 1959 to December 31, 1963 and extension agreements for 1964 and 1965. ASCAP has refused to execute the tendered agreements for the simple reason that appellant has not yet tendered the license fees retroactively due under the agreements. Thus appellant is today apparently perfectly willing to violate what it asserts to be Washington law. The only thing it remains unwilling to do is pay money.

ASCAP advised infringing broadcasting stations that performances of copyrighted musical compositions in the Society's repertory would constitute infringement unless the prior consent of the copyright proprietors or of the Society had been obtained (R. 30, Fact 41, App. A, p. 26, Fact 64).

And, beginning in 1961, appellees and other copyright proprietors commenced lawsuits against 11 unlicensed radio stations in the State of Washington, including the present appellant (R. 30, Fact 40, App. A, p. 26, Fact 63).

Except for this case, all of these lawsuits have now been settled by the broadcasters' taking ASCAP licenses retroactive to 1959—thus putting the infringers on a par with the broadcasters who had taken the licenses issued pursuant to Judge Ryan's order (R. 49).

ASCAP's Compliance with Washington Law.

For many years, and particularly in 1961, 1962 and 1963, ASCAP, on behalf of appellees and other members, has filed with the Secretary of State of the State of Washington a catalog of their copyrighted musical compositions, together with forms of licenses available to all would-be users in the State of Washington (P. Ex. 1, P. Ex. 5, P. 6, D. Ex. A-7, D. Ex. A-8, D. Ex. A-8a). As Judge Solomon found, no public official of the State of Washington has ever requested ASCAP to make any change in either the form or substance of its filings.

In making these filings, ASCAP relied on and was guided by a letter dated August 23, 1948, from the Attorney General of the State of Washington to the Secretary of State of the State of Washington (of which ASCAP received a copy) in which the Attorney General stated that, in his opinion, the filing made by ASCAP in the office of the Secretary of State on April 20, 1948 was in compliance

with Chapter 19.24, R. C. W. (P. Ex. 9, App. A, p. 24, Fact 53).

In consequence of these filings, ASCAP and its members have fully complied with the provisions of Chapter 19.24, R. C. W.

Summary

We submit that the single most important fact in this case is this: by virtue of the 1959 Washington rate-fixing proceeding, at any time after November 20, 1959, appellant could have obtained a license from ASCAP, valid under Washington law, to perform publicly for profit any musical composition in ASCAP's repertory, subject only to its obligation to pay a license fee which Chief Judge Ryan had determined to be reasonable—with the approval of appellant's present counsel.

Appellant had five options available to it, four of which were lawful:

Appellant could have obtained a blanket license and along with it the right to play as much or as little, as frequently or as rarely, any of the compositions in the ASCAP repertory. Or appellant could have obtained a per program license which would have required it to pay a license fee only for those programs in which appellant broadcast music from the ASCAP repertory.

And, if the foregoing alternatives were unacceptable to appellant, it could have undertaken to deal with ASCAP members directly.

Or appellant could have refrained from giving public performances for profit of music in the ASCAP repertory.

Instead, appellant chose the fifth—the unlawful—alternative. Appellant never obtained any license. It never sought to deal with anyone. It continued its unconscionable conduct in appropriating appellees' property without cause and without justification.

Summary of Argument

1. The affirmative defenses based on Washington law are without merit. Appellees and ASCAP have complied in every respect with the statutory requirements of Ch. 19.24, R. C. W. Moreover, even if appellees—or ASCAP —had not complied with a local Washington statute, that non-compliance could not be used as a defense in this suit brought in a federal court to protect appellees' rights under federal law.

2. The affirmative defenses based on federal law are without merit. Appellees have not unlawfully extended their copyright monopolies nor are they guilty of violating the antitrust laws in any other respect. Moreover, appellant, which has never exercised the rights granted by Section IX of the Amended Final Judgment, has no standing to claim that it has been damaged or prejudiced by appellees' conduct or by ASCAP's conduct.

3. In the circumstances of this case, where appellant is a deliberate and wilful infringer and where appellees' infraction of the antitrust laws, if it exists, is at best doubtful and marginal, enforcement of the Copyright Law against appellant clearly outweighs enforcement of the antitrust laws against appellees.

I.

THE AFFIRMATIVE DEFENSES BASED ON WASHINGTON LAW ARE WITHOUT MERIT

There are two answers to appellant's contention that appellees have violated Chapter 19.24, R. C. W.: First, it is just not so. Second, even if appellees had violated a local Washington statute, their violations would be irrelevant

in this suit, brought in a federal court to protect appellees' rights under federal law.

We shall begin by demonstrating that the Washington statute has not been violated:

The Filing Requirements.

Appellees have fully complied with the filing requirements of §§ 19.24.040, 19.24.050 and 19.24.055, R. C. W., and Judge Solomon so ruled (App. A, p. 30, Conclusion 6). As we have seen, no Washington public official has ever suggested otherwise (App. A, p. 24, Fact 52).

Appellant now contends that the filing requirements of the state statute were not complied with because ASCAP's members (including appellees) never filed individually under the state law—only ASCAP filed on behalf of all its members. But the statute will be read in vain for any requirement that the individual ASCAP member must duplicate the filings already made by ASCAP.

In appraising appellant's contention that the Washington statute should be read as requiring double filings, the Court will perhaps wish to know that the record is barren of any suggestion that appellant or any other Washington broadcaster ever inspected any ASCAP filing.

"Extortion and Terror."

Appellant claims that appellees and other ASCAP members have violated § 19.24.060, R. C. W., by bringing lawsuits against infringing broadcasters in the State of Washington. Appellant professes to see these suits as part of a "systematic campaign . . . to illegally fix prices . . . through the use of extortionate means and terrorizing practices," violative of the statute. We suggest that it would be more appropriate to view these suits as an effort by appellees and other members of ASCAP, after having been

despoiled of their rights for many years, to put an end to piracy and to redress the rights granted to them by Congress pursuant to the Copyright Clause of the Constitution.

Appellant professes to find such evidence in the fact that Rogan Jones was joined as a defendant in one of the actions commenced against International Good Music, Inc. The answer to appellant's claim is to be found in Judge Solomon's finding (App. A, p. 9, Fact 10)—amply supported by the record (Tr. 277-279, 288-289, 310-312, R. 30, Fact 7)—that

> "Defendant Jones is and has been the dominant influence in defendant International Good Music, Inc. and has determined its policies for more than 25 years. It was his decision:
>
> "(a) that copyrighted musical compositions should be broadcast regularly over radio stations owned and operated by defendant International Good Music, Inc. without the consent of the copyright owner and without license from any licensing agency;
>
> "(b) that no license fee or royalty should be paid to any copyright owner or to any licensing agency."

In short, defendant Jones was joined as a party because—as Judge Solomon found—his conduct was "particularly flagrant" (App. A, p. 6).

Issuing Blanket Licenses.

Appellant contends that § 19.24.020, R. C. W., bars issuance of "blanket" licenses without exception and that ASCAP's offering of "blanket" licenses should operate to bar its members from enforcing their rights under the Copyright Law. The section provides:

> "It shall be unlawful for two or more persons holding or claiming separate copyrighted works under the copyright laws of the United States, either within or without the state, to band together, or to pool their interests for the purpose of fixing the prices on the use of said copyrighted works, or to pool their separate interests or to conspire, federate, or join together, for the purpose of collecting fees in this state, or to issue blanket licenses in this state, for the right to commercially use or perform publicly their separate copyrighted works: *Provided, however,* Such persons may join together if they issue licenses on rates assessed on a per piece system of usage:. . . ."

The words of § 19.24.020 conceivably permit two readings as to whether blanket licenses are always forbidden. It is arguable that § 19.24.020 makes it absolutely unlawful "to issue blanket licenses in this state" whether or not per piece licenses are also offered. For the statute makes unlawful a whole series of acts including "to band together," "to pool their separate interests," "to federate, or join together" and "to issue blanket licenses," and the proviso says only that "such persons may *join* together if they issue licenses on rates assessed on a per piece system of usage" (emphasis added). Thus, it is logically possible to argue that the issuance of per piece licenses permits only "joining"; it remains unlawful to do all the other acts enumerated. Regardless of the offering of a per piece license it may be argued, no two copyright proprietors may "band together," or "pool their separate interests," or "federate" or "issue blanket licenses."

But the statutory language may far more sensibly be read as permitting "blanket licenses," "federating," etc., provided per piece licenses are also offered.

This Court must decide which of the two readings makes better sense—and so should be deemed the reading which the Washington Legislature intended.

Appellant's reading of the statutory language as an absolute bar on blanket licenses, we submit, has little in logic to commend it. It can scarcely be lawful to "join," but not to "band together" or "pool" or "federate"—no meaningful distinction among these acts can be perceived. And if it is as lawful to band together, pool or federate as it is to join—provided per piece licenses are offered—then it must be lawful also to issue blanket licenses, provided per piece licenses are offered. The proviso cannot refer to two or three of the enumerated acts and not to all.

Consideration of the statutory purpose leads to the same reading which is suggested by logic. We are dealing, after all, with an anti-monopoly statute—§ 19.24.060 subjects the music business to the police power of the State "in order to prohibit, discourage and prevent monopolistic practices." This objective is entirely accomplished by reading § 19.24.020 as permitting blanket licenses if per piece licenses are offered as an alternative—since the statute requires also that the per piece license rates be no higher in Washington than in other states. For while a blanket license (a license charging a percentage of all receipts regardless of how much music is used) might be an oppressive device under some circumstances if it were the only form of license offered, no harm could result if non-discriminatory per piece licenses (where payment is made only as the music is used) were simultaneously offered.

Precisely this thinking, of course, underlies the Amended Final Judgment (D. Ex. A-2). There, as we have seen, ASCAP is permitted to issue blanket licenses—which offer great convenience to the user as well as to ASCAP—but ASCAP is required also to offer per program licenses at

rates which offer the prospective licensee a "genuine economic choice" between blanket and per program (Sec. VII). The Amended Final Judgment was drawn under the federal antitrust laws, which have as their target the same monopolistic practices against which the Washington Legislature acted. In deciding which of two possible readings of § 19.24.020 to accept—whether it bars all blanket licensing or permits it provided a reasonable alternative is offered—it makes sense to accept the reading which parallels the requirements of federal law.

Finally, we would note that Judge Ryan, Judge Solomon and the Attorney General of Washington have all reviewed ASCAP's licenses in the light of Ch. 19.24, and all have concluded that the blanket licenses are lawful in view of the simultaneous offering of per program licenses.

"Pooling Copyrights" and "Price Fixing".

There is, we submit, no substance to appellant's contention that appellees and other ASCAP members have "pooled" their separate copyrighted interests in ASCAP for the purpose of fixing prices in violation of § 19.24.020.

To begin, it is stipulated and Judge Solomon found that each appellee has at all times stood ready to negotiate for a separate license to perform any of his musical compositions (R. 30, Fact 27, App. A, p. 23, Fact 50). There was no testimony at the trial that any would-be user of music in Washington ever asked any appellee or any other plaintiff for a separate license and was refused. Under these circumstances, there can be no finding that appellees have pooled their interests or otherwise joined together to fix prices. The fact is that appellees have joined ASCAP because such a clearing-house is needed for them and for users—but they have always stood willing to deal as individuals (App. A, p. 12, Fact 25).

In addition, as we have seen, ASCAP has no power to fix license fees for the right to perform the music in its repertory. Under the Amended Final Judgment (D. Ex. A-2), any would-be user has the absolute right to have the United States District Court for the Southern District of New York determine a reasonable license fee.

Moreover, the proviso in § 19.24.020 reads:

> "Such persons may join together if they issue licenses on rates assessed on a per piece system of usage."*

ASCAP and its members, we submit, issue licenses "on rates assessed on a per piece system of usage" in two ways. First, ASCAP offers per program licenses which assess rates "on a per piece system of usage." And, second, ASCAP's individual members at all times stand ready to license individually—the would-be user need only ask. (Appellant, it should be noted, has never sought to deal individually with any ASCAP member or any other copyright proprietor [App. A, pp. 23-24, Fact 50].)

1. *The Per Program License.* Turning first to the ASCAP per program license, the issue is whether its rates are "assessed on a per piece system of usage."

It will be recalled that, under a per program license, a broadcaster pays a fee to ASCAP only on a program which uses ASCAP music. Thus, in effect, with a per program license a broadcaster buys the right to perform ASCAP music by the piece; it is within the broadcaster's

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*Ch. 19.24 nowhere defines the term "per piece system of usage." Appellant's suggestion on p. 45 of its brief that § 19.24.140 does provide such a definition is erroneous. Section 19.24.120 at great length sets forth a complex procedure for civil enforcement of Ch. 19.24. It does not purport to define—and it does not define—the term "per piece system of usage." Insofar as we know, the enforcement procedures of § 19.24.140 have never been utilized.

exclusive province to tailor his own programs so that the program is the piece; the broadcaster himself determines whether he wants one piece or more and the size of and nature of each piece. Moreover, the license fee itself is a percentage of an amount which the broadcaster himself determines, the amount he charges a sponsor for his program—neither ASCAP nor the copyright owner has any voice in determining the price which the broadcaster charges for the time segment during which he uses ASCAP music.

Appellant seems to contend that only a license which either (a) charges the same sum for performance of any composition in the licensing organization's repertory, or (b) charges a specified sum for each performance of a named composition, is permissible under the statute. Neither of these two techniques is feasible.

ASCAP's repertory embraces such little-known works as "A Jardineira," "A La Cubana" and "A La Nanita Nana." The Washington Legislature surely could not have intended to require that the same fee be charged for these compositions as is charged for "White Christmas," "Easter Parade," "Stardust," a Bartok concerto, a Copland suite or a Gershwin rhapsody.

Nor could ASCAP establish a separate schedule of rates for each of the hundreds of thousands of compositions in its repertory. To be fair to its members, ASCAP would have to give an opportunity to each member to submit his own schedule of rates for each of his works; the member and ASCAP would have to consider dozens of different factors as to each composition and each use: the particular user, the nature of the use, the amount received by the user, the popularity of the composition, time of day broadcast, season of the year (the rate for "White Christmas" should surely vary between Christmas Day and July 4), power of the station, etc. Preparing such detailed schedules would be administratively impossible.

The Washington Legislature, we respectfully suggest, could not have intended to permit only the impossible when it permitted "rates assessed on a per piece system of usage." Hence, the statutory language should not be construed as permitting only the impossible. Rather, the words should be given the reasonable reading which their flexible language suggests. Reading them reasonably, the ASCAP "per program" license fits the "per piece" provision.

The court below so concluded. In his opinion, Judge Solomon said (App. A, p. 5):

> "The enforcement of the Washington statute, as construed by the defendants, would not only jeopardize the efficient licensing and policing of performance for profit, which can only be done by licensing organizations such as ASCAP, . . . but it would also deprive plaintiffs and all other copyright owners of the privilege of profiting from their federally granted copyright monopoly.
>
> "To construe the provisions of the Washington statute . . . so as to make the acts of plaintiffs or ASCAP in this case unlawful would raise grave questions concerning the constitutionality of the Washington statute under the Fourteenth Amendment. . . ."

Having these considerations in mind, Judge Solomon ruled (App. A, p. 31, Conclusion 11):

> "The ASCAP per program license may reasonably be regarded as assessing rates 'on a per piece system of usage' as the Washington statute uses that phrase."

Were there any doubt, it might well be resolved by recalling the problem at which the Legislature aimed in

enacting Ch. 19.24. In 1937, the only form of radio license that ASCAP offered in Washington or anywhere else was the blanket license; the per program license did not exist. Not until the Consent Decree of 1941 was ASCAP required to offer per program licenses.

Thus, in 1937, a would-be user of ASCAP music had to take a blanket license or nothing—he had no alternative. And under a blanket license, even if a theoretical broadcaster wanted to play ASCAP music only two or three times a year, he had to pay ASCAP a percentage of all revenues received throughout the year. This was the problem with which the Legislature sought to cope by enacting Chapter 19.24, by requiring that a user be offered, as an alternative to the blanket license, a license where rates are "assessed on a per piece system of usage."

The per program license gives the broadcaster the option which the Legislature intended to insure. Under a per program license, the user does not pay for ASCAP music when he does not play it; he pays only on programs using ASCAP music. In conformity with the Legislature's requirement, he is free to play only what he needs, and pay for it as it is used—in precise effect, by the piece.

There is one further reason to construe the statutory language as permitting ASCAP's per program license: under the Amended Final Judgment, ASCAP is required to issue per program licenses (D. Ex. A-2, Sec. VII [B]) and is forbidden to issue licenses for specific compositions unless both the user and the ASCAP member in interest so request, in writing (Sec. VI). Hence, if the statute were read as appellant here demands—as forbidding per program licenses and requiring licenses of individual compositions—it would be in flat conflict with the Amended Final Judgment. Of course, the Legislature in 1937 did not have the Amended Final Judgment of 1950 before it.

But in construing a state statute in 1965, in choosing between two permissible readings, a court is surely entitled by considerations of comity to accept the reading which will avoid conflict with a federal judgment. It is not lightly to be assumed that the Washington Legislature would seek conflict with the requirements of federal law.

We have noted that the Washington Attorney General in 1948 formally rendered to the Secretary of State an opinion that the ASCAP per program license makes offering of the blanket license lawful. In 1962, as appellant points out, the Attorney General wrote a letter to a member of the State Senate terming the per program license a "blanket" license and hence illegal (D. Ex. A-14). The letter-writer offered no analysis or citation of authority, only his one-sentence *ipse dixit*. In one sense, the description is correct: the per program license is "blanket" in that, like the traditional blanket license, it covers the entire ASCAP repertory, and authorizes the licensee to use any and all compositions in the ASCAP repertory without a separate license for each use. But the letter-writer failed to observe that the traditional blanket license is "blanket" in two senses: first, a single license permits the use of any and all compositions in the repertory without separate negotiations for each use (a factor of great advantage to the user); and, second, the rate base on which its charges are assessed includes all revenues. It is this latter sense in which the traditional blanket license might impose a burden unless an alternative were available—the station performing three ASCAP compositions yearly might have to pay a license fee calculated on its full year's revenues. It seems reasonable to conclude that this is the possibility against which the Legislature acted. But the per program license is not "blanket" in this latter sense—the rate base is only the revenues derived from programs using ASCAP music. There is no conceiv-

able threat in a license which is "blanket" only in that it permits use of an entire repertory under a single license. There is no reason to believe that the Legislature (which did not define "blanket licenses") sought to bar licenses which are "blanket" only in this sense—they are not dangerous, merely convenient. Hence, the Attorney General erred in asserting that the per program license is illegally "blanket."

2. *Individual Licensing by ASCAP Members.* Even if appellant were right, and the proviso in § 19.24.020 permitted only licenses of specific individual compositions, ASCAP and its members would still meet the statutory test. For under the Amended Final Judgment, as we have seen, ASCAP's members retain the absolute right to license their individual compositions, and, indeed, ASCAP is barred to license specific compositions except upon specific joint request of user and member (Sec. VI, D. Ex. A-2).*

The freedom of ASCAP's members to deal individually is not here questioned. On the basis of a stipulation by the parties, the court below found (R. 37, Fact 51):

> "Plaintiffs have at all times in the last ten years been ready to negotiate with any broadcaster in the State of Washington for a license to perform any of plaintiffs' copyrighted musical compositions on any

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*Appellant seeks to make much of the alleged fact that whenever Washington broadcasters wrote to ASCAP asking for "per piece" licenses, ASCAP allegedly did not even reply (Appellant's Brief, p. 48). First, it should be noted that none of these requests were made pursuant to Section VI of the Amended Final Judgment which regulates ASCAP's right to issue licenses for the performance of specific compositions. Second, it is not true that ASCAP did not reply—Louis Weber, ASCAP's assistant sales manager in charge of radio and television, testified at his deposition that he did respond to such requests by advising broadcasters of the licenses that were available to them. Prior to 1959, he told them about the blanket and per program licenses available prior to the 1959 rate-fixing proceedings. Since 1959, he has told them about the blanket and per program licenses available as a result of the 1959 rate-fixing proceeding (Weber Dep., p. 9, D. Ex. 31-d).

> mutually agreeable basis, including 'rates assessed on a per piece system of usage.' In the last ten years, no broadcaster in the State of Washington has requested such a license from any plaintiff. No defendant has ever made any attempt to contact any plaintiff individually for the purpose of obtaining licenses to play any of plaintiffs' compositions on a 'per piece' or any other basis."

Two consequences flow from these unquestioned facts. First, without regard to the per program license, plaintiffs are ready to offer whatever licenses for specific compositions the user may desire. Hence the proviso of § 19.24.020 is satisfied concerning "licenses on rates assessed on a per piece system of usage."

Far more importantly, however, the availability of licenses from individual members, as we have already seen, completely bars application of Chapter 19.24 to ASCAP and its members. For Chapter 19.24 refers to copyright proprietors who "band together" or "pool their interests" or "conspire, federate or join together." ASCAP's members have not so "banded together" or "pooled." They say: "Deal with us individually, or collectively, whichever you wish." There is, in consequence, no "band," no "pool."

The Court will recall that the facts were otherwise in 1937, when Chapter 19.24 was enacted—then, since ASCAP had exclusive grants from its members, the would-be user could deal with ASCAP, or stop performing ASCAP music. Even in 1941, after the first decree in *United States* v. *ASCAP*, it could still be contended that ASCAP constituted a "banding together," since, while ASCAP's members were free to license individually, the proceeds of their licensing went to ASCAP (D. Ex. A-1, Sec. II[1][a]). Only with the Amended Final Judgment in 1950 were the members—and the public—guaranteed the

right to make such individual license arrangements as they might desire, by the ban on ASCAP's receiving other than a non-exclusive license (D. Ex. A-2, Sec. IV[A]).

Since 1950, then, it has been impossible to term ASCAP a "pool" or a "banding together." These actions require a degree of mutual commitment, and ASCAP's members have none. ASCAP today exists as a convenient alternative to individual negotiation, nothing more—it is not an entity forbidden by any statute aimed at "banding together," "pooling" or the like.

* * *

Each of the contentions now made by appellant regarding appellees' alleged violations of Chapter 19.24, R. C. W., was made before Judge Solomon. Each was rejected by him. His decision is, we submit, clearly correct and should be affirmed.

II

THE ALLEGED VIOLATIONS OF WASHINGTON LAW CONSTITUTE NO DEFENSE

Even should the Court find that appellees have violated Washington law, appellant could not urge these violations as defenses to this infringement action: First, by virtue of the Supremacy Clause of the United States Constitution, no state can deny to appellees the rights and benefits conferred by federal law. Second, appellant's confiscation of appellees' property can not be justified by conduct on the part of appellees which did not involve any wrongdoing against the appellant and which did not prejudice or mislead it.

Leo Feist, Inc. v. *Young,* 138 F. 2d 972 (7th Cir. 1943), is, we submit, directly in point on both issues. There plaintiff, a publisher member of ASCAP, sought an injunction

and damages for infringement. In the District Court, defendant conceded that he had infringed plaintiff's copyright but claimed that plaintiff was deprived of its right to maintain its infringement suit because it had failed to comply with the provisions of a certain Wisconsin statute.

The Wisconsin statute provided that no person, association or corporation other than the "true or original composer" could, directly or indirectly, issue licenses or other agreements for the public rendition of copyrighted musical numbers by persons within Wisconsin, unless said person, association or corporation first obtained a license from the Secretary of State to transact such business. An applicant for a license was obliged to file certain information with the Secretary of State and to pay a franchise tax equivalent to 25% of its gross receipts from persons within Wisconsin. The statute also provided that anyone who attempted, by threats of suit or other means, to compel persons in the State of Wisconsin to purchase copyright licenses was guilty of a misdemeanor, unless he had first obtained a license.

Plaintiff conceded that it had violated the statute and the District Court, after a trial on the merits, sustained defendant's contention that plaintiff's violation of the statute was a good defense. The Court dismissed plaintiff's complaint, 46 F. Supp. 622.

On appeal, the Court of Appeals for the Seventh Circuit reversed. The Court first considered the effect of the Wisconsin statute and concluded that violation of the statute could not operate as a bar to the bringing of a copyright infringement suit (138 F. 2d at 974):

> "We do not believe that the Wisconsin statute should be permitted to prohibit the bringing of a federal suit. The Federal Copyright Act lays down a prohibition against the appropriation of the pro-

> prietor's copyrighted composition unless consent is given. And it is familiar doctrine that the prohibition of a federal statute may not be set at naught by a state statute. Sola Electric Co. v. Jefferson Electric Co., 317 U. S. 173, 176, 63 S. Ct. 172, 87 L. Ed. 165. Therefore, since a right would not long be respected if it could be violated with impunity, the remedy of an infringement action in the federal courts must still be open to plaintiff. Correlatively, the benefits of a federal statute may not be denied by a state statute, Sola Electric Co. v. Jefferson Electric Co., supra; see Orlando Candy Co. v. New Hampshire Fire Ins. Co., D. C. 51 F. 2d 392, 393."

The Court then turned to the question of whether, under equity principles, plaintiff's conduct could justify defendant's appropriation of plaintiff's property. The Court said (138 F. 2d at 974-5):

> "By refusing to grant plaintiff's prayer, the District Court not only deprived plaintiff of its copyright, but in effect gave judicial blessing to defendant's confiscation of it. Since equity seeks above all else to do justice, we cannot agree that a court should supinely sit by while such unlawful appropriation occurs. It is an elementary maxim of equity jurisprudence that there is no wrong without a remedy, and certainly plaintiff chose the proper forum and followed the statutorily prescribed procedure by which to assert that remedy. The District Court stated that a court of equity 'will not permit itself to be used as an instrumentality by which a party may effectuate a violation of positive law or for the evasion of the requirements of ethics and mor-

> ality,' citing many authorities therefor. But by the court's inaction, defendant's violation of the copyright statute was sanctioned and the unethical appropriation was approved. The authorities cited by the District Court are not controlling here because the conduct of the plaintiff in them was fraudulent and directly connected with the issues being litigated, whereas here plaintiff has not been guilty of any inequity, unconscionable act, or wrongdoing towards the defendant. Neither has it misrepresented its musical work, which forms the basis of this action, or the copyright thereof, either to the defendant, or to the public.
>
> "In our view, a rule of equity should never be applied if its application results in injustice, which would result here if plaintiff were not allowed to enforce its congressionally bestowed right to prevent unauthorized use of its copyright. True, plaintiff failed to comply with the Wisconsin statute. But the rule is not inexorable that a plaintiff who comes into court with unclean hands is always to be denied relief, regardless of other circumstances in the case; for, if the defendant has been guilty of conduct more unconscionable and unworthy than that of the plaintiff, the rule may be relaxed. Goodyear Tire & Rubber Co. v. Overman Cushion Tire Co., 6 Cir., 95 F. 2d 978, 983."

Finally, the Court noted that its decision did not mean that plaintiff could not be held responsible to the state of Wisconsin. But it concluded that (138 F. 2d at 976):

> ". . . plaintiff's failure to secure a license was an offense against Wisconsin of which it alone could take cognizance; and plaintiff's dereliction in this

> regard in no wise prejudiced the defendant or justified him in confiscating plaintiff's property. We think the clean hands maxim should be applied only where it promotes right and justice, not by way of punishment for extraneous transgressions. See Keystone Driller Co. v. General Excavator Co., 290 U. S. 240, 245, 54 S. Ct. 146, 78 L. Ed. 293; Ohio Oil Co. v. Sharp, 10 Cir., 135 F. 2d 303, 307; Chicago v. Union Stock Yards & Transit Co., 164 Ill. 224, 238; 45 N. E. 430, 35 L. R. A. 281.
>
> * * *
>
> "We are not approving plaintiff's noncompliance with the Wisconsin statute, and we think Wisconsin may hold plaintiff accountable for the tax required by the statute as well as punishing it for not obtaining the required licenses. But orderly administration of justice requires that, on issues properly framed, the question be relegated for determination to the Wisconsin courts."

Feist v. *Young* provides a precise and controlling rule for the case at bar. Here, as there, appellant seeks to deprive appellees of their rights under federal law by resort to a state statute, and seeks to justify its confiscation of appellees' property by alleging conduct on the part of appellees wholly unconnected with appellant's unlawful acts. The federal courts have not permitted federal rights —conferred by the Constitution and laws of the United States—to be so easily defeated.

Guidance is given also by *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173 (1942); the Court said (317 U. S. at 176):

> "When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the

> statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield. Constitution, Art. VI, cl. 2; *Awotin* v. *Atlan Exchange Bank,* 295 U. S. 209; *Deitrick* v. *Greaney,* 309 U. S. 190, 200-01."

Many other cases are to the same effect. For example, the federal courts have refused to give effect to state statutes, limiting or prohibiting an employee's right to strike, on the ground that these statutes conflicted with an employee's rights under federal law. *Automobile Workers Union* v. *O'Brien,* 339 U. S. 454 (1950); *Amalgamated Ass'n of Street Electric Railway & Motor Coach Employees* v. *Wisconsin Employment Relations Board,* 340 U. S. 383 (1951). In the last cited case, the Supreme Court said (340 U. S. at 394-6):

> ". . . where . . . the state seeks to deny entirely a federally guaranteed right which Congress itself restricted only to a limited extent in case of national emergencies, however serious, it is manifest that the state legislation is in conflict with federal law. . . . Such state legislation must yield as conflicting with the exercise of federally protected labor rights."

We submit that the foregoing authorities demonstrate the insufficiency of the defenses based on appellees' alleged violations of Washington law. Whatever control Washington may choose to exercise over combinations of copyright owners, the fact remains that appellant is a wilful infringer of appellees' federal copyrights. Washington law may not deprive appellees of their right to enforce their copyrights.

Moreover, even if appellees were part of a combination fixing prices in the state of Washington, even if they had failed to satisfy Washington's filing requirements, there would still be no justification for appellant's unconscionable conduct in appropriating appellees' property. This Court should not "supinely sit by while such unlawful appropriation occurs" and should not give "judicial blessing to defendant's confiscation" of appellees' property, *Leo Feist, Inc.* v. *Young, supra,* at 975. Appellees have not "been guilty of any inequity, unconscionable act, or wrongdoing towards the defendant," nor have they "misrepresented [their] musical work[s] . . . either to the defendant, or to the public," *Ibid.* See also *Interstate Hotel Co.* v. *Remick Music Corp.,* 157 F. 2d 744 (8th Cir 1946), *cert. denied,* 329 U. S. 809 (1947), where the Court said, adjudging infringement in circumstances paralleling those at bar (157 F. 2d at 749):

> "Of the remaining assignments of error, little need be said. One is that the appellees should be denied relief in a Federal court of equity on the ground that they come into court with unclean hands. The basis for this assignment seems to be that appellees were guilty of some nefarious conduct by refusing to engage in business in Nebraska on the conditions permitted by Nebraska law, by instituting these suits for the protection of their copyrights at the same time and trying them together, and by participating in and accepting the benefits of the activities of the American Society of Composers, Authors, and Publishers in States in which the activities of the Society are legal. The appellants are in poor position to question the motives and character of appellees when they themselves are guilty of wrongfully appropriating appellees' property. Leo

> Feist, Inc. v. Young, 7 Cir., 138 F. 2d 972. Such considerations aside, this assignment hardly merits comment."

Washington law should not be construed so as to grant to appellant the right to take appellees' property without paying for it. As the Court pointed out in *Leo Feist, Inc.* v. *Demarie,* 16 F. Supp. 827 (W. D. La. 1935), when plaintiffs' noncompliance with a Louisiana licensing statute was urged as a defense to a copyright suit (16 F. Supp. at 828):

> ". . . the action is one for the violation of a copyright granted by the federal government, and it will not be assumed that the Legislature meant to deny a litigant the right to go into a federal court for the protection of the property right granted by federal laws except upon conditions prescribed by the state Legislature, in the absence of clear language indicating such purpose."

In sum, Washington has not—and it could not constitutionally—give appellant the right to appropriate appellees' property.

III.

THE AFFIRMATIVE DEFENSES BASED ON FEDERAL LAW ARE WITHOUT MERIT

We do not comprehend the basis for appellant's contention that appellees, together with ASCAP, have violated the federal antitrust laws.

Appellant's brief uses almost all the epithets known to federal antitrust law—"price-fixing," "unlawful extension of copyrights," "block booking," "tying agreements,"

"blind selling practices," etc. But after all the words have been used—after all the irrelevant citations of cases have been put forward—the following still remain as hard facts:

ASCAP has no power to fix license fees. Every would-be user of ASCAP's repertory has an absolute right to obtain a license from the Society and an absolute right to obtain a judicial determination of a reasonable license fee.

Moreover, the legality of ASCAP's activity under the antitrust laws is under the constant scrutiny of the Department of Justice and the United States District Court for the Southern District of New York where the ASCAP consent decree is administered (App. A, p. 3).

We do not comprehend how appellant, which has never exercised the rights granted by Section IX of the Amended Final Judgment, can now complain that it has been damaged or prejudiced by ASCAP's conduct.

We can go further:

On the record before this Court, it is plain that ASCAP, governed by the Amended Final Judgment, has not violated any antitrust law but has, in fact, established a classically free market in musical compositions. Buyers and sellers of the right to perform musical compositions are guaranteed free access to each other, and if their bargaining does not produce agreement on a fair price, a judge is standing by to adjudicate the matter.

On the supply side, any composer, author or publisher is insured ready access to the market where songs are licensed: under the Amended Final Judgment, no one may be excluded from membership in ASCAP who meets certain minimal standards.

On the demand side, the Amended Final Judgment gives every user of music an absolute right to obtain a license to the entire ASCAP repertory on non-discriminatory terms. He can not be excluded from the market by

virtue of anyone's control of all or any part of it (and the right of a user to deal with individual copyright proprietors is preserved by the Amended Final Judgment's bar against ASCAP's interference in such dealings).

Finally, the reasonableness of the prices charged by the suppliers to the consumers is subject to judicial determination. And the burden of establishing reasonableness is on the supplier.

Appellant purports to see in ASCAP's blanket and per program licenses something akin to tie-in sales (where a seller refuses to sell Item A unless Item B is purchased simultaneously) or to "block booking" (a form of tie-in sometimes employed in the motion picture industry, whereby an exhibitor can not obtain licenses to films separately, but is forced to license a whole group of films) see *United States* v. *Paramount Pictures, Inc.*, 334 U. S. 131 (1948); *United States* v. *Loew's, Inc.*, 371 U. S. 38 (1962). The evil in these practices is that the buyer is compelled to buy what he does not want in order to obtain what he does want.

But ASCAP imposes no such compulsion. True, it does offer licenses to its entire repertory—in effect offering a licensee a library card to use whatever he wishes. And broadcasters regularly seek such licenses because of the convenience they offer. But a broadcaster is absolutely free to deal with the individual copyright proprietor if he wishes a license for only one song. The broadcaster is not faced with the all-or-nothing proposal which raises antitrust objections to block booking and other forms of tie-ins.

Appellant repeatedly cites *Hazeltine Research, Inc.* v. *Zenith Radio Corporation,* 239 F. Supp. 51 (N. D. Ill. 1965). But that case is of no pertinence here. In *Hazeltine,* the court held that the holder of a group of patents violated the Sherman Act when it insisted in licensing the patents as a group, and offered licenses on single patents only "at royalty rates far in excess of the package rate . . . to force

by unlawful coercion the acceptance of unwanted patents," 239 F. Supp. at 77. Thus, in *Hazeltine,* the prospective licensee who sought a license for an individual patent had no real choice but to take a license for the pool—and therein lay the evil, as in the tie-in and block booking cases. As we have seen, however, a broadcaster has a full range of choices —he may take a blanket license, or a per program license, or he may deal with individual proprietors. The choice is his, and it is unrestrained. Moreover, in *Hazeltine* the prospective licensee—unlike the user of music in ASCAP's repertory—could not obtain a judicial determination of a reasonable license fee. Hence *Hazeltine* is of no application.

Alden-Rochelle and Witmark

Although appellant has no facts to support its contentions, it has sought to find the applicable law in *Alden-Rochelle, Inc.* v. *ASCAP,* 80 F. Supp. 888 (S. D. N. Y. 1948), and *M. Witmark & Sons* v. *Jensen,* 80 F. Supp. 843 (D. Minn. 1948). Both cases involved ASCAP's relations with motion picture exhibitors over 17 years ago—*prior to the 1950 Amended Final Judgment.*

As the Court of Appeals for the Second Circuit pointed out in *Shenandoah Valley Broadcasting, Inc.* v. *ASCAP,* 331 F. 2d 117, 121 (2d Cir. 1964), *cert. denied,* 371 U. S. 997 (1964):

> "The Amended Final Judgment of March 14, 1950, considerably amplified an earlier consent judgment entered in the Government's antitrust suit against ASCAP nine years before. The 1941 judgment contained many negative injunctions with respect to licensing, but had no provision specifically addressed to television, which had not yet been developed commercially, and no provision for judicial fixing of license fees if a licensee and ASCAP were unable to agree on terms. The 1950 Judgment

> was designed, in part, to fill these gaps, as well as to meet the problems with respect to motion picture licensing revealed by Alden-Rochelle, Inc. v. ASCAP, 80 F. Supp. 888 (S. D. N. Y. 1948) and M. Witmark & Sons v. Jensen, 80 F. Supp. 843 (D. Minn. 1948)."

In recognition of the changes thus wrought, we may note, Judge Leibell vacated the injunctive order which he had entered in *Alden-Rochelle.*

In consequence, *Alden-Rochelle* and *Witmark* are of only historical interest today. Neither is of any pertinence here.

Appellant's "Conspiracy"

In its eager hunt for a reason to avoid paying for its infringements, appellant comes up with one last devil: it contends that ASCAP and its members have entered into a "conspiracy" to refuse to grant licenses to recording companies for public performance of recorded musical compositions on broadcasting stations. If not for this "conspiracy," says appellant, record companies could obtain performance rights which would inure to the benefit of radio stations which played recorded music on the air. Since almost all of the music played by appellant is recorded music, appellant says, it could thereby avoid the necessity of paying for the right to perform copyrighted musical compositions.

The basic flaw in appellant's contention is that it is a creation of imagination rather than evidence. Not one single piece of evidence can be adduced to support appellant's charges of "conspiracy". There is no tacit understanding among ASCAP's members not to license performing rights to record companies. ASCAP and each

member of ASCAP have the unfettered right to license performing rights to record companies. It is stipulated that no such license is in existence—but it is stipulated also that no record company has ever asked for such a license (R. 30, Facts 63, 64, 65, 66). Judge Solomon thus summarized and found the facts (App. A, p. 28, Fact 75):

> "There is no evidence that plaintiffs or other members of ASCAP have entered into a conspiracy to prevent recording companies from obtaining licenses authorizing broadcasting stations to perform publicly for profit any musical composition."

Evidently, record companies are just not interested in going into the business of obtaining performance rights. And, we might suggest, for good reason. Record companies make money by selling records to the public for home consumption. The records which they sell or give to radio stations are but a tiny fraction of their business. Consequently, it makes no sense for a record company to obtain a performing rights license. The record company—which stands to gain little or no profit from sales to radio stations—has no reason to assume the broadcaster's responsibility of arriving at mutually agreeable terms with the owners or licensors of performing rights.*

The sham nature of appellant's argument with respect to record companies is demonstrated by the testimony of

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*We may note here the provisions of the Copyright Law dealing with royalty payments for recording rights. 17 U. S. C. § 1 provides in pertinent part:

> ". . . whenever the owner of a musical copyright has used or permitted or knowingly acquiesced in the use of the copyrighted work upon the parts of instruments serving to reproduce mechanically the musical work, any other person may make similar use of the copyrighted work upon the payment to the copyright proprietor of a royalty of 2 cents on such part manufactured, to be paid by the manufacturer thereof . . .;"

one of defendants' own witnesses at the trial. Mr. Lee Facto, who is in charge of the production of musical tapes for International Good Music, Inc., testified that these tapes are sold to other radio stations across the country (Tr. 257-258). But Mr. Facto, although he places copyrighted musical compositions on tapes, although he sells these tapes to other stations knowing that there will be public performances for profit, does not undertake to obtain performance rights for the music put on the tapes (Tr. 261-262). That, in his words, is "the individual responsibility" of the stations which put the tapes on the air (Tr. 263). And so it is—as we have shown—with record companies.

IV.

IN THE CASE AT BAR, ENFORCEMENT OF THE COPYRIGHT LAW AGAINST APPELLANT CLEARLY OUTWEIGHS ENFORCEMENT OF THE ANTITRUST LAWS AGAINST APPELLEES

Even if by some manipulation ASCAP's arrangements and practices might be brought into verbal collision with language in the precedents, that would not necessarily condemn appellees to the forfeiture of their rights. That would be but the beginning, not the end, of the inquiry. The antitrust laws nowhere declare in so many words that one who has trespassed upon them shall automatically be denied the benefits conferred by the Copyright Law. The barrier to enforcement of copyrights by antitrust violators is one created by equity, and must be measured by equitable standards.

In *Alfred Bell & Co.* v. *Catalda Fine Arts, Inc.,* 191 F. 2d 99 (2d Cir. 1951), defendants raised an antitrust

defense to a claim of copyright infringement. In affirming judgment for plaintiff, the Court said (191 F. 2d at 106):

> "We have here a conflict of policies: (a) that of preventing piracy of copyrighted matter and (b) that of enforcing the anti-trust laws. We must balance the two, taking into account the comparative innocence or guilt of the parties, the moral character of their respective acts, the extent of the harm to the public interest, the penalty inflicted on the plaintiff if we deny it relief. As the defendants' piracy is unmistakably clear, while the plaintiffs' infraction of the anti-trust laws is doubtful and at most marginal, we think the enforcement of the first policy should outweigh enforcement of the second."

In the case at bar, "defendant's piracy is unmistakably clear." Appellees' infraction of the antitrust laws, if it existed, would be "doubtful and at most marginal"; it has surely caused appellant no damage, and it has not prejudiced or misled appellant in any way. In these circumstances, enforcement of the copyright laws is clearly in the public interest and would far outweigh enforcement of the antitrust laws against these appellees—even had they been guilty of any violation.

CONCLUSION

Appellant, we submit, is in error when it argues that this is a long and complicated lawsuit involving many facts and many issues. To the contrary, this is a simple case. The facts have been largely stipulated by the parties. Appellant has been unable to offer the slightest hint of error in any finding of fact made by the court below—let alone to demonstrate that any finding is "clearly erroneous." And

the findings which appellant contends the court should have made are either unsupported by the record, or irrelevant or repetitious.

The issues are simple—appellant has unlawfully and without just cause appropriated appellees' property. Its defenses based both on Washington law and the federal antitrust laws have no merit—neither factually nor legally.

Judge Solomon carefully considered each of the contentions made here by appellant and found them all to be totally lacking in merit. We respectfully submit that the judgment below should be affirmed.

Respectfully submitted,

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October 11, 1965.

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAY H. TOPKIS
Attorney for Appellees

APPENDICES

Appendix A

IN THE

United States District Court

FOR THE WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

TEMPO MUSIC, INC., ET AL., *Plaintiffs,* *vs.* INTERNATIONAL GOOD MUSIC, INC., *Defendant.*	CIVIL ACTION No. 5548
IRVING BERLIN, ET AL., *Plaintiffs,* *vs.* INTERNATIONAL GOOD MUSIC, INC., *Defendant.*	CIVIL ACTION No. 5773
COLE PORTER, ET AL., *Plaintiffs,* *vs.* ROGAN JONES and INTERNATIONAL GOOD MUSIC, INC., *Defendants.*	CIVIL ACTION No. 242 (Bellingham)
GERSHWIN PUBLISHING CORPORATION, ET AL., *Plaintiffs,* *vs.* K-91, INC., *Defendant.*	CIVIL ACTION No. 5771
IRVING BERLIN, ET AL., *Plaintiffs,* *vs.* WESCOAST BROADCASTING CO., *Defendant.*	CIVIL ACTION No. 2258
BETTY COMDEN, ET AL., *Plaintiffs,* *vs.* WESCOAST BROADCASTING CO., *Defendant.*	CIVIL ACTION No. 2415

2

Memorandum Opinion

SOLOMON, Judge: September 15, 1964

Irving Berlin, Richard Rodgers, Cole Porter and other owners of copyrights to more than 150 musical compositions, including such well-known songs as "White Christmas", "Easter Parade" and "Day and Night", filed actions against three radio broadcasting corporations and Rogan Jones, the president and principal stockholder of one of them, claiming violations of the federal copyright law. They seek statutory damages, orders enjoining defendants from future infringement of their copyright works, as well as attorney fees and costs.

Defendants admit the expropriation and the infringement of plaintiffs' copyrights, but they assert that plaintiffs are barred from maintaining this action because, among themselves and in conjunction with the American Society of Composers, Authors and Publishers (ASCAP), plaintiffs have conspired to fix prices and to engage in other unlawful practices in violation of the Constitution and the laws of the State of Washington, particularly Chapter 218, 1937 Session Laws (RCWA, Chapter 19.24) and the federal antitrust laws. Defendants also assert that plaintiffs have unlawfully extended their individual copyright monopoly in violation of the copyright laws, and that by reason of "unclean hands" they have neither legal nor equitable standing to maintain these actions.

Defendants at an earlier stage of these proceedings, before a different Judge, moved to join ASCAP as a party. The motion was denied. However, the defendants assert that while ASCAP may not be a necessary party, its activities are relevant because it acts as a licensing agent for the plaintiffs and because of plaintiffs' illegal arrangements with it.

Memorandum Opinion

Plaintiffs are among 8800 members of ASCAP, whose combined inventory of over one million musical compositions is commonly referred to as the ASCAP repertory. The relationship between ASCAP and its members, as well as the operations of ASCAP as a licensing agent of the members, has been under the scrutiny of the United States Department of Justice for more than a decade. Its practices are guided by the Amended Final Decree of 1950 and the order entered in the same action on January 7, 1960. All of the plaintiffs granted ASCAP a non-exclusive right to license non-dramatic performances for profit of their copyrighted compositions.

Under the terms of the Amended Final Decree, ASCAP may not license the use of the individual compositions except on application of both user and copyright owner and ASCAP may not refuse to license prospective users of compositions from its repertory. In case of disputes concerning license fees, the Amended Final Judgment provides for judicial determination of reasonable fees in the United States District Court for the Southern District of New York.

Plaintiffs have reserved the right to license their own compositions to any user on any mutually agreeable basis, and in these cases the plaintiffs as individuals seek to enforce their copyrights.

Most of the evidence in this case was stipulated in a long and carefully prepared pre-trial order. I have studied the statement of admitted facts, the evidence adduced at the trial, the exhibits, as well as the excellent memoranda of authorities submitted by both the plaintiffs and the defendants, and I have concluded that the plaintiffs are entitled to prevail.

I had hoped to prepare a written opinion setting forth not only my reasons for such conclusion, but also an analysis

of the authorities upon which I relied. However, illness as well as the press of other judicial business has prevented me from doing this. I believe that the interests of the parties will be served best by announcing my decision without further delay. I also concluded that such an opinion would be of limited value because there are practically no controverted issues of fact and because both plaintiffs and defendants are represented by competent counsel who will present adequately their arguments to the Court of Appeals.

I find that plaintiffs have complied with the statutory requirements of the State of Washington. Defendants have failed to prove that ASCAP's registration of the songs in its repertory was inadequate or that plaintiffs or ASCAP violated the Washington law relating to the pooling of copyright interests without providing for per piece licensing (RCWA 19.24.020); or that the filing of these and other actions by the plaintiffs to enforce their rights under the copyright laws constituted an abuse of either State or Federal process. There is no evidence of any abusive practices by either the plaintiffs or their licensing agent which would deny them copyright protection.

I further find that there is no merit in defendants' contention that they did not take licenses with ASCAP because they feared State prosecution. I find that they failed to take licenses only because they wanted to avoid paying license fees on the same basis charged other broadcasting companies. I further find that defendants made no attempt to contact plaintiffs individually for the purpose of obtaining licenses to play plaintiffs' songs on a per piece or any other basis.

Defendants have admitted that it would be virtually impossible to deal with the composers on an individual basis for the rights to perform their songs for profit. Their

contentions as to what the law requires would not only make it virtually impossible to police the use of copyrighted songs, but would also greatly increase the cost of administration. The enforcement of the Washington statute, as construed by the defendants, would not only jeopardize the efficient licensing and policing of performance for profit, which can only be done by licensing organizations such as ASCAP, BMI or SESAC, but it would also deprive plaintiffs and all other copyright owners of the privilege of profiting from their federally granted copyright monopoly.

To construe the provisions of the Washington statute (RCWA, Chapter 19.24) so as to make the acts of the plaintiffs or ASCAP in this case unlawful would raise grave questions concerning the constitutionality of the Washington statute under the Fourteenth Amendment to the Constitution of the United States.

Plaintiffs have not unlawfully extended their copyright monopolies through a combination among themselves or with ASCAP, nor are they guilty of violating the federal antitrust laws in any respect alleged by the defendants. However, even if plaintiffs' conduct in any respect can be considered a violation of either RCWA, Chapter 19.24, or the federal copyright or antitrust laws, their violations are so minimal and the violations of the defendants so unconscionable that plaintiffs should not be deprived of the right to maintain these actions for the deprivation of their property.

I also find the defendant Rogan Jones, who is and has been the dominant influence in defendant International Good Music, Inc., and who has determined its policies for more than 25 years, is equally liable with the corporation for these infringements.

Memorandum Opinion

In accordance with Section 101 of the Copyright Law (17 U. S. C. A. § 101), plaintiffs have elected to seek statutory damages in lieu of actual damages and profits. For the violation of each copyright, statutory damages not exceeding the sum of $5,000 nor less than $250 may be assessed. Defendants have deliberately appropriated the property of plaintiffs as well as the property of many other copyright owners for more than a quarter of a century, and they have greatly profited by their wrongful conduct. The conduct of International Good Music, Inc., and its president Rogan Jones has been particularly flagrant. However, I have decided to fix damages for each violation at only $350.00 jointly against defendant International Good Music, Inc., and defendant Rogan Jones. I have decided to fix damages against Westcoast Broadcasting Co. and K-91, Inc., for each violation at $250.00.

The prevailing parties are also entitled to attorney fees as part of costs. The parties stipulated that I may fix the fees without taking testimony. I realize that plaintiffs' attorneys will charge much more than I will allow them and that they are entitled to such higher fees. Although $15,000.00 is a modest fee to allow plaintiffs in all of the consolidated cases, I will allow that amount. It may be allocated among the cases in accordance with the amount of statutory damages allowed in each case.

Plaintiffs are also entitled to an injunction restraining the defendants from future infringement of plaintiffs' copyrighted songs.

Defendants' counterclaims are dismissed.

Counsel for plaintiffs shall prepare appropriate findings of fact, conclusions of law and a judgment for plaintiffs, all in accordance with this memorandum opinion.

Findings of Fact and Conclusions of Law

IN THE

UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

[SAME TITLE]

The above-entitled actions came on for trial on February 11, 1964. The Court, having considered the pre-trial order and the statement of agreed facts contained therein, the evidence adduced at the trial, the exhibits, and the memoranda of authorities submitted by both plaintiffs and defendants, now makes the following Findings of Fact and Conclusions of Law:

> Note: Unless otherwise stated, the word "defendants" refers to the corporate defendants and not to defendant Jones.

FINDINGS OF FACT

JURISDICTION

1. These actions are brought under the Copyright Law.

2. Plaintiffs were and now are the owners of the copyrights of the musical compositions here alleged to have been infringed.

Findings of Fact and Conclusions of Law

3. Defendants are engaged in the business of operating commercial radio broadcasting stations under licenses granted by the Federal Communications Commission. Defendant International Good Music, Inc. is the owner and operator of radio station KGMI in Bellingham, Washington. Defendant Wescoast Broadcasting Co. is the owner and operator of radio station KPQ in Wenatchee, Washington. Defendant K-91, Inc. is the owner and operator of radio station KIXI in Seattle, Washington.

4. Defendants operate their radio stations commercially with a profit motive, in interstate commerce.

5. At all times here pertinent, defendant Jones has owned and now owns more than 80% of the outstanding stock of defendant International Good Music, Inc., and has been and now is the president and a director thereof.

Copyright Infringement

6. On various dates in and about 1961 and 1962, defendants broadcast 183 musical compositions in which plaintiffs then owned and now own the copyrights; included were such songs as "Blue Skies," "I Get a Kick Out of You," "Begin the Beguine," "You Go to My Head," "You Made Me Love You" and "Falling in Love with Love." Among the plaintiffs are such composers as Irving Berlin, Cole Porter, Leonard Bernstein, Richard Rodgers, Allan Jay Lerner and Frederick Loewe.

7. All broadcasts of a particular musical composition referred to in Finding 6 were public performances for profit and were made without payment of any royalty and with-

out the express consent of any owner of the performing rights.

8. For at least ten years, each defendant has regularly broadcast the musical compositions of plaintiffs and of other authors, composers and publishers for profit, without payment of royalty or compensation to any person.

9. The performances referred to in Findings 6, 7 and 8 were made pursuant to deliberate policy, long persisted in, and without any regard to the rights of plaintiffs and other copyright proprietors under the federal copyright law. Each defendant corporation was managed by persons experienced in radio broadcasting.

10. Defendant Jones is and has been the dominant influence in defendant International Good Music, Inc. and has determined its policies for more than 25 years. It was his decision:

(a) that copyrighted musical compositions should be broadcast regularly over radio stations owned and operated by defendant International Good Music, Inc. without the consent of the copyright owner and without license from any licensing agency; and

(b) that no license fee or royalty should be paid to any copyright owner or to any licensing agency.

11. Radio station KPQ performs publicly for profit 6,000 musical compositions per year. Many such compositions are broadcast more than once each year. Among the musical compositions broadcast more than once each year are standards such as "White Christmas," "Easter Parade" and "Stardust."

12. Radio station KPQ broadcasts 60,000 playings of musical compositions per year.

13. At all times here pertinent, responsible officers of defendant International Good Music, Inc. were aware of the catalog of copyright entries published by the United States Register of Copyrights and publicly available through the United States Superintendent of Documents.

14. At all times here pertinent, responsible officers of defendant International Good Music, Inc. never visited the office of the Secretary of State of the State of Washington in Olympia, Washington to examine the information there available concerning the copyright proprietors of the musical compositions to be performed on radio station KGMI. Responsible officers of defendant International Good Music, Inc. were aware that such information was available.

ASCAP

15. At all times here pertinent, each of the plaintiffs was and is now a member of the American Society of Composers, Authors and Publishers ("ASCAP").

16. ASCAP is an unincorporated membership association organized under the laws of the State of New York comprising over 8,000 author, composer and publisher members who own copyrights in various separate musical compositions.

17. The musical compositions in which the members of ASCAP own copyrights are commonly referred to as constituting its repertory.

Findings of Fact and Conclusions of Law

18. ASCAP is one of three music licensing organizations in the United States which among them license non-dramatic public performances for profit of substantially all of the copyrighted musical works in the United States. More than 50% of all performances of copyrighted music by broadcasing stations are performances of compositions which ASCAP members have created.

19. Each of the musical compositions here shown to have been infringed is now and at all times here pertinent was a part of the ASCAP repertory.

ASCAP and Its Members

20. The relationship between ASCAP and the plaintiffs and the other members of ASCAP is set forth in (a) the General Agreement; (b) the Television Agreement; (c) the ASCAP Articles of Association; (d) the Amended Final Judgment of March 14, 1950 entered in an action in the United States District Court for the Southern District of New York entitled "United States of America, plaintiff, against American Society of Composers, Authors and Publishers, defendant," Civil Action No. 13-95; and (e) the order of January 7, 1960 entered in the same action.

21. Pursuant to the terms and conditions of the documents referred to in Finding 20, each plaintiff, prior to the date of the alleged infringement, had granted to ASCAP the non-exclusive right to license non-dramatic public performances for profit of all the compositions written, composed or published by such plaintiff during the term of his or its membership in ASCAP, and had received the right to share in royalty distributions made by the Society.

22. Notwithstanding the grant described in Finding 21, at all times here pertinent, each plaintiff retained and had the right to license public performances for profit of each of his or its musical compositions.

ASCAP's Licensing Function

23. The ASCAP repertory changes from day to day, and even from hour to hour, as new compositions are added, or old compositions fall into the public domain, or members resign.

24. In radio broadcasting, split second timing is necessary and musical compositions must be available to be put on the air quickly.

25. The licensing of public performances for profit of copyrighted musical compositions by licensing organizations such as ASCAP is the only practical way by which copyright proprietors may exercise their federally-granted right to license non-dramatic performances of their copyrighted compositions. No single copyright proprietor could deal individually with all would-be users of his copyrighted compositions, and it would be impossible for him to police the use of his copyrighted songs. Equally, most broadcasters and other users of copyrighted music could not deal separately with the thousands of copyright proprietors whose music they perform.

The Amended Final Judgment

26. ASCAP's licensing activity is regulated and controlled by the Amended Final Judgment of March 14, 1950.

Under Section IX of the Amended Final Judgment, when any would-be user of any, some or all of the compositions in the ASCAP repertory applies in writing to ASCAP for a license, ASCAP is required to advise him of the fee which it deems reasonable for the license requested. The making of the written application operates automatically to license the applicant. If the parties are unable to agree upon a reasonable fee, the applicant may apply to the United States District Court for the Southern District of New York for determination of a reasonable fee. In any such proceeding, the burden is on ASCAP to establish the reasonableness of the fee which it has requested. During the pendency of the proceeding, the applicant's license continues in effect, provided he makes such interim payments as the Court may direct. Thus ASCAP has no power to fix license fees, since any would-be user has the absolute right to have the Court determine a reasonable license fee.

27. After a reasonable fee has been finally determined by the Court, Section IX(C) of the Amended Final Judgment requires ASCAP to offer a license at a comparable fee to all other applicants similarly situated who thereafter request a license.

28. Under Section IV(C) of the Amended Final Judgment, ASCAP is forbidden at all times, in its licensing, to discriminate "in license fees or other terms and conditions between licensees similarly situated".

29. Under Section VI of the Amended Final Judgment, ASCAP is prohibited from granting to any user a license to perform one or more specified compositions in the ASCAP repertory, unless both the user and member or

members in interest have requested ASCAP in writing to do so, or unless ASCAP, at the written request of the prospective user, shall have sent a written notice of the prospective user's request for a license to each such member at his last known address and such member shall have failed to reply within thirty days thereafter.

Broadcasters' Use of Section IX of the Amended Final Judgment

30. Would-be users of ASCAP music have made extensive use of the provisions of Section IX of the Amended Final Judgment. Since 1950, radio and television broadcasters have regularly joined together in industry-wide committees for the purpose of negotiating licenses with ASCAP. Whenever such negotiations have been unsuccessful, the broadcasters have exercised the rights conferred by Section IX and commenced Court proceedings for determination of reasonable license fees. Defendants herein have never been members of or connected with such industry-wide committees.

Chapter 19.24, R. C. W.

31. Chapter 19.24, R. C. W., was enacted by the Legislature of the State of Washington in 1937.

32. Section 19.24.020, R. C. W. provides:

> "Unlawful combinations—Per piece royalties—Parting with right to restrict use. It shall be unlawful for two or more persons holding or claiming separate copyrighted works under the copyright laws of the United States, either within or without

the state, to band together, or to pool their interests for the purpose of fixing the prices on the use of said copyrighted works, or to pool their separate interests or to conspire, federate, or join together, for the purpose of collecting fees in this state, or to issue blanket licenses in this state, for the right to commercially use or perform publicly their separate copyrighted works: *Provided, however,* Such persons may join together if they issue licenses on rates assessed on a per piece system of usage: *Provided, further,* This chapter shall not apply to any one individual author or composer or copyright holder or owner who may demand any price or fee he or she may choose for the right to use or publicly perform his or her individual copyrighted work or works: *Provided, further,* Such per piece system of licensing must not be in excess of any per piece system in operation in other states where any group or persons affected by this chapter does business, and all groups and persons affected by this chapter, are prohibited from discriminating against the citizens of this state by charging higher and more inequitable rates per piece for music licenses in this state than in other states: *Provided, further,* Where the owner, holder, or person having control of any copyrighted work has sold the right to the single use of said copyrighted work, where its sole value is in its use for public performance for profit, and has received any consideration therefor, either within or without the state, then said person or persons shall be deemed to have sold and parted with the right to further restrict the use of said copyrighted work or works."

33. Section 19.24.040, R. C. W. provides:

"Listing of pooled copyrighted works required. In the event two or more persons holding separate copyrighted musical works, or any rights flowing therefrom, whether by assignment, agency agreements, or by any form of agreement, pool their interests, or combine, or conspire, federate, or join together in any way, whether for a lawful purpose or otherwise, a complete list of their copyrighted works or compositions shall be filed once each year in the office of the secretary of state of the state of Washington, together with a list of the prices charged or demanded for their various copyrighted works; no payment or filing fee shall be required by the secretary of state, and said persons, corporations, or association, foreign or domestic shall state therein under oath, that said list is a complete catalogue of the titles of their claimed compositions, whether musical or dramatic or of any other classifications, and in addition to stating the name and title of the copyrighted work it shall recite therein the date each separate work was copyrighted, and the name of the author, the date of its assignment, if any, or the date of the assignment of any interest therein, if any, and the name of the publisher, the name of the present owner, together with the addresses and residences of all parties who have at any time had any interest in such copyrighted work. The secretary of state shall require two copies of said list, one of which he shall keep on file, the other shall be forwarded to the office of the state treasurer at Olympia."

34. Section 19.24.050, R. C. W. provides:

"Lists of copyrighted works—Open to public—Publication provided for. The foregoing list of names and titles, provided for in the preceding section, shall be made available by the secretary of state to all persons for examination, in order that any user of copyrighted works in this state may know the rights and the titles to such copyrighted works as may be claimed by any of said combinations, pools, associations, or persons as aforesaid; said lists shall be prepared so that all persons may avoid using said copyrighted compositions, if they so desire, and may avoid conflict therewith, and avoid committing innocent infringements of said works; and in order to further effectuate the copyright laws of the United States, the secretary of state shall, if he deems it necessary to protect the citizens of this state from committing innocent violations of the copyright laws of the United States, publish such list once each year in a newspaper of general circulation, in order that all citizens of the state may respect any and all individual rights granted by the United States copyright laws."

35. Section 19.24.055, R. C. W. provides:

"Filing required of nonresident and foreign copyright holders—Exception. No person, corporation, or association, domestic or foreign, whether doing business in this state as hereinafter defined or not, shall be absolved from the foregoing duty of filing said list of holdings as required in the preceding sections of this chapter, if their music or copy-

righted works are used commercially in this state, or have been used herein, whether originating from a point within the state or from without, and as long as any rendition thereof is received or heard within the state, or is intended to be so received by the originator of any musical program: *Provided, however,* Any individual owner of a copyrighted work or works, not a party to or not connected in any way with any pool, conspiracy, combination, or groups, or association of persons, as prohibited by this chapter, need not file any such list."

36. Section 19.24.060, R. C. W. provides:

"Declaration of purpose of legislation—Situs of copyrighted work. It is hereby declared that the production and creation of music and the commercial use of music and of copyrighted works within this state, whether originating at a point from within or without the state, as long as the same shall be rendered and publicly received within the confines of this state, whether mechanically or by radio communication, is a business clothed and affected with the public interest, and the adult educational advantages engendered by the public use of music and in its creation, makes this business one of public necessity, and necessary for the education and training of the youth of this state; that many abuses are practiced under a false guise of federal protection which only the state with its police power can easily and lawfully restrain, and in order to prohibit, discourage, and prevent monopolistic practices, and to prevent extortion, to encourage free bargaining between

the citizens of this state with each other and with those without the state, and in order to give greater effect to the constitutional provisions relating to monopoly and price fixing, and in the general interest of the public, therefor, the legislature in the interest of the peace and dignity of the state, in the interest of good morals and the general welfare of the people of this state, and for greater educational advantages to the public, declares that said business shall be subject to the police power and reasonable regulation of the state government, and such police and regulating power shall be administered by the courts and other officials of this state in a manner consistent with, in aid of, and never in conflict with, the copyright laws of the United States. The provisions of this chapter, and the administration thereof, shall at all times effectuate the enforcement, the true intent, and meaning of the United States copyright laws in order to prevent abuses from being practiced within this state from points within or from points without the state, by any individual, corporation, or organizations, who attempt to use the federal courts as innocent instrumentalities in the furtherance of any systematic campaign or scheme designed to illegally fix prices for the commercial use of copyrighted works in this state through the use of extortionate means and terrorizing practices based on threats of suits, and an abuse of both state and federal process, all of which are declared to be in violation of this chapter and of the State Constitution; it is further declared that any person or persons, or combines, as aforesaid, who shall violate this chapter shall be deemed to have used

their property within this state in such a way that the same shall have acquired a legal situs, analogous to the situs of other personal tangible property within the state, even though separate from the domicile and residence of the owner: *Provided, further,* The legal situs of any copyrighted work is coextensive about the state, and a copyrighted work used or sold for public use or public performance for profit, if intended to be heard from a point without the state or from a point within the state, is hereby declared to be a commercial commodity, and its legal situs is hereby declared to be within the state of Washington."

37. Section 19.24.290, R. C. W. provides:

"Violations—Penalties. Every person, in addition to the other penalties provided in this chapter, who violates or who procures, or aids or abets in the violating of any provision of this chapter, or who conspires to render ineffectual any valid order or decision of any court in the enforcement of this chapter, or who procures, conspires with, or aids or abets any person or persons in his or their failure to obey the provisions of this chapter, or to render ineffectual any valid order of any court in connection with the enforcement of this chapter shall be deemed guilty of a gross misdemeanor, and upon conviction, shall be punished by a fine not exceeding five hundred dollars, or imprisonment in the county jail for not more than six months, or both such fine and imprisonment."

THE 1959 WASHINGTON SECTION IX PROCEEDING

38. In 1958, certain broadcasters in the State of Washington stopped paying fees to ASCAP under existing license agreements on the alleged ground that payment of such license fees would violate Ch. 19.24, R. C. W.

39. The license agreements referred to in Finding 38 expired on December 31, 1958.

40. In 1959, a group of broadcasters, including eleven broadcasters located in the State of Washington, commenced a proceeding in the United States District Court for the Southern District of New York under Section IX of the Amended Final Judgment for determination of reasonable fees for licenses to be effective as of January 1, 1959.

41. In that proceeding, the Court ruled that, in the circumstances presented, ASCAP would not be directed to issue licenses to any petitioning broadcasters in the State of Washington.

42. Thereafter, and until November 20, 1959, ASCAP did not offer licenses to broadcasters in the State of Washington.

43. On November 20, 1959, the owners of 61 Washington radio stations filed a petition in the United States District Court for the Southern District of New York asking that Court to issue an order

> "(a) directing ASCAP to grant to petitioners and others similarly situated who may join herein, licenses for the right of public performance of

compositions in the ASCAP repertory by the radio and television stations operated by them within the State of Washington;

"(b) determining and establishing the terms and conditions of such licenses."

44. At the request and with the consent of the petitioners, the Court (Ryan, C. J.) entered an order on November 20, 1959 directing ASCAP to issue licenses to the petitioners in one of two specified forms for the period January 1, 1959 through December 31, 1963. The Court ruled:

> "6. Taking into consideration the provisions of the Amended Final Judgment herein, the regulation of the activities of the respondent thereunder and the scope of its activities pursuant thereto, and giving due regard to the enactment of Revised Code of Washington, C. 19.24—Laws of 1937, C. 218, the licenses which the Society is hereby directed to issue may lawfully be entered into between respondent and petitioners, and respondent is hereby directed to enter into such license agreements with each of the petitioners.
>
> "7. The provisions in said agreements for the disposition of claims for the period prior to June 1, 1959 are reasonable and do not discriminate against other users in the State of Washington or other states."

45. The two specified license forms were the so-called "blanket" and "per program" radio licenses. Both licenses

grant the licensee the right to perform whatever ASCAP music he desires, whenever he desires. Under the blanket license, the fee charged is 2.125% of the licensee's over-all revenues from sale of time on the air, after extensive deductions. Under the per program license, the licensee pays a higher percentage, but the fee is based only on the revenues from programs on which compositions in the ASCAP repertory are performed.

Defendants' Refusal to Take Licenses

46. Defendants were fully apprised of the proceedings before Judge Ryan.

47. The license forms established by the order of November 20, 1959, were available to defendants.

48. Defendants failed to apply for or execute either form of license.

Licensing Activity of ASCAP and Plaintiffs in Washington

49. The only licenses issued by ASCAP to broadcasters in the State of Washington now or at the time of infringement are licenses in the forms annexed to the order of November 20, 1959.

50. Plaintiffs have at all times in the last ten years been ready to negotiate with any broadcaster in the State of Washington for a license to perform any of plaintiffs' copyrighted musical compositions on any mutually agreeable basis, including "rates assessed on a per piece system

of usage." In the last ten years, no broadcaster in the State of Washington has requested such a license from any plaintiff. No defendant has ever made any attempt to contact any plaintiff individually for the purpose of obtaining licenses to play any of plaintiffs' compositions on a "per piece" or any other basis.

51. In the last ten years, ASCAP has not received any request from any broadcaster in the State of Washington and any ASCAP member in interest for the issuance of a license to perform one or more specified compositions.

Compliance with Washington Law (R. C. W. § 19.24)

52. In each of the last three years, in attempted compliance with R. C. W., §§ 19.24.040, 19.24.050, 19.24.055 on behalf of plaintiffs and other members, ASCAP has filed with the Secretary of State of the State of Washington a catalog of its members' copyrighted musical compositions, together with forms of licenses available to all would-be users in the State of Washington. No public official of the State of Washington has requested ASCAP to make any change in either the form or substance of ASCAP's filings. Specifically, no Washington public official has made any complaint that ASCAP's per program license does not assess rates on a per piece system of usage.

53. In making the filings referred to in Finding 52, ASCAP relied on and was guided by a letter dated August 23, 1948, from the Attorney General of the State of Washington to the Secretary of State of the State of Washington (of which ASCAP received a copy) in which the Attorney General stated that in his opinion the filing made by

ASCAP in the office of the Secretary of State on April 20, 1948 was in compliance with Chapter 19.24, R. C. W.

54. At all times here pertinent, plaintiffs have received royalties for the publication of their copyrighted musical compositions which are usually paid according to the number of sales of individual sheet music or records.

55. ASCAP is paying the expenses connected with the prosecution of all actions now pending in Washington for infringement of copyright of compositions in the ASCAP repertory in which the firm of Holman, Marion, Black, Perkins & Coie represents plaintiffs.

56. ASCAP selected and retained the law firm of Paul, Weiss, Rifkind, Wharton & Garrison of New York as attorneys of counsel for the plaintiffs in said actions.

57. ASCAP arranged to obtain the information in the complaints that defendants performed the musical compositions alleged to have been infringed.

58. ASCAP has continued since the date of the alleged infringements to have people or organizations in the State of Washington monitor unlicensed broadcasting stations for possible copyright infringements.

59. Said monitoring was done at ASCAP's request.

60. ASCAP has authority to commence these actions on behalf of plaintiffs.

61. ASCAP has authority to commence other suits for alleged copyright infringement of musical compositions in ASCAP's repertory held by the plaintiffs.

62. ASCAP has authority to arrange for settlement of such actions.

63. In the past year and one-half, plaintiffs and other members of ASCAP have brought 15 suits against 11 radio stations in Washington, alleging 272 infringements.

64. ASCAP, through its agents and legal representatives, has at all times pertinent hereto advised infringing broadcasting stations, including defendants, that performances by such stations of copyrighted musical compositions in the Society's repertory would constitute infringement of such copyrights unless the prior consent of the individual owners of performing rights in such compositions or of the Society had been obtained.

THREATS OF PROSECUTION UNDER CH. 19.24, R. C. W.

65. Neither defendant Jones nor any officer of any defendant corporation has ever been threatened with prosecution under Chapter 19.24, R. C. W. There is no evidence that any broadcaster in the State of Washington has ever been so threatened, although the majority of Washington broadcasters have taken licenses from ASCAP, have paid royalties and have publicly participated in judicial proceedings to obtain such licenses.

66. Defendants' failure to take licenses from ASCAP was not because they feared prosecution under Chapter 19.24 R. C. W. Defendants failed to take licenses only because they wanted to avoid paying license fees on the same basis charged to—and paid by—other broadcasting companies.

Miscellaneous

67. Under Section XV of the Amended Final Judgment, membership in ASCAP is open to all qualified persons and ASCAP is not permitted to deny membership to any such person because of affiliation with any record company.

68. Some corporate plaintiffs, and other corporate members of ASCAP, are subsidiaries of or otherwise affiliated with record companies.

69. Each member of ASCAP may assign or license performing rights to recording companies.

70. Most phonograph records are marked as to the name of the licensing organization that is authorized to license the music contained on the record; virtually all records are marked to show the names of the writers and publishers; copies of ASCAP's membership list are publicly available.

71. Recording companies generally acquire only the recording rights to musical compositions as distinguished from the performing rights.

72. At the time of the alleged infringement and now, there were and are no licenses in effect between ASCAP or any plaintiff and any recording company authorizing any broadcasting station to perform publicly for profit any musical composition.

73. ASCAP has never offered any such license to recording companies nor has any such license ever been requested.

74. None of the plaintiffs has ever offered any such license to recording companies nor has any such license ever been requested.

75. There is no evidence that plaintiffs or other members of ASCAP have entered into a conspiracy to prevent recording companies from obtaining licenses authorizing broadcasting stations to perform publicly for profit any musical composition.

76. License agreements between ASCAP and radio networks license affiliated stations to perform compositions in the ASCAP repertory on network programs, but do not authorize local stations affiliated with the networks to perform compositions in the ASCAP repertory on non-network programs.

77. No part of the license fees paid to ASCAP by any radio network is for public performance of compositions in the ASCAP repertory on non-network programs.

Damages

78. The Court finds the following awards of damage appropriate in light of the circumstances here presented and in the exercise of its discretion:

a) $350 for each infringement, or a total of $1,750 in *Tempo Music, Inc. et al.* v. *International Good Music, Inc.,* Civil Action No. 5548;

b) $350 for each infringement, or a total of $21,000 in *Irving Berlin, et al.* v. *International Good Music, Inc.,* Civil Action No. 5773;

c) $350 for each infringement, or a total of $25,200 in *Cole Porter, et al.* v. *Rogan Jones and International Good Music, Inc.,* Civil Action No. 242 (Bellingham), both defendants to be jointly liable for all such damages;

d) $250 for each infringement, or a total of $1,000 in *Gershwin Publishing Corporation et al.* v. *K-91, Inc.,* Civil Action No. 5771;

e) $250 for each infringement, or a total of $3,500 in *Irving Berlin, et al.* v. *Wescoast Broadcasting Co.,* Civil Action No. 2258; and

f) $250 for each infringement or a total of $7,000 in *Betty Comden, et al.* v. *Wescoast Broadcasting Co.,* Civil Action No. 2415.

79. The Court finds that plaintiffs are entitled to reasonable attorneys' fees, as part of the costs, in the amount of $15,000., to be allocated among the cases in accordance with the amount of statutory damages allowed in each case.

CONCLUSIONS OF LAW

1. The Court has jurisdiction over plaintiffs' claims for copyright infringement under the federal copyright law and of defendants' counterclaims under the federal anti-trust laws and Washington law.

2. Defendants infringed plaintiffs' copyrighted musical compositions by performing the compositions publicly for profit without the consent of the copyright owner or of anyone else who had the right to license public performances for profit of the compositions.

3. During the last ten years, defendants have committed numerous other infringements of plaintiffs' copyrighted musical compositions and of the copyrighted musical compositions of other authors, composers and publishers.

4. Defendant Jones is liable for the copyright infringements complained of in *Cole Porter, et al.* vs. *Rogan Jones and International Good Music, Inc.,* Civil Action No. 242 (Bellingham).

5. Defendants' defenses based upon Ch. 19.24, R. C. W., are without merit and cannot be used to defeat plaintiffs' claims for copyright infringement.

6. In consequence of ASCAP's filings with the Secretary of State of the State of Washington in each of the last three years, ASCAP and its members have fully complied with the provisions of § 19.24.040, 19.24.050 and 19.24.055, R. C. W.

7. By bringing lawsuits against infringing broadcasters in the State of Washington, neither plaintiffs nor other ASCAP members have violated § 19.24.060, R. C. W. No abuse of Federal or State process results from plaintiffs' bringing the present actions to compel infringing broadcasters to honor plaintiffs' rights under the Copyright Law nor from writing letters demanding that their rights be respected.

8. Plaintiffs have not lost the right to restrict performances of their copyrighted works by reason of § 19.24.020, R. C. W. Plaintiffs' grant to ASCAP of a non-exclusive right to license public performances is not a

sale of the right to the single use of such copyrighted work within the meaning of § 19.24.020, R. C. W. In addition, the sole value of plaintiffs' copyrighted works is not in their use for public performances for profit. Plaintiffs receive substantial royalties for the publication of their works in sheet music, for recordings, and for other uses.

9. Plaintiffs and other ASCAP members have not pooled their separate copyrighted interests in ASCAP for the purpose of fixing prices in violation of § 19.24.020, R. C. W. While ASCAP's members grant to ASCAP a non-exclusive right to license, each member retains the right to deal on his own behalf.

10. Section 19.24.020, R. C. W. permits "pooling" if the participants in the pool "issue licenses on rates assessed on a per piece system of usage."

11. The ASCAP "per program" license may reasonably be regarded as assessing rates "on a per piece system of usage" as the Washington statute uses that phrase. The willingness of ASCAP's individual members to negotiate for licenses containing rates assessed on a per piece system of usage also constitutes compliance with the statute.

12. ASCAP and its members fully comply with the requirements of § 19.24.020, R. C. W.

13. Defendants' contentions as to the requirements of Ch. 19.24., R. C. W., would deprive plaintiffs and all other copyright owners of their federally granted property rights.

14. To construe the provisions of Ch. 19.24., R. C. W., so as to make the acts of the plaintiffs or ASCAP in these

cases unlawful, would raise grave questions concerning the constitutionality of the Washington statute under the Fourteenth Amendment to the Constitution of the United States.

15. Defendants' defenses and counterclaim based on the federal antitrust laws are without merit.

16. Plaintiffs have not unlawfully extended their copyright monopolies through a combination among themselves or with ASCAP, nor are they guilty of violating the federal antitrust laws in any respect alleged by defendants or otherwise.

17. In view of the rights granted to defendants by Section IX of the Amended Final Judgment, defendants cannot complain that they have been damaged or prejudiced by ASCAP's conduct.

18. Neither plaintiffs nor other members of ASCAP have entered into a conspiracy to prevent recording companies from obtaining licenses authorizing any broadcasting station to perform publicly for profit any musical composition.

19. Even if plaintiffs' conduct in any respect could be considered a violation of either Washington law or the federal antitrust laws, such violations are so minimal and the violations of the defendants so unconscionable that plaintiffs should not be deprived of the right to maintain these actions for the deprivation of their property.

20. In accordance with 17 U. S. C. § 101, and in the exercise of the Court's discretion, plaintiffs are entitled to the following damages:

a) $350 for each infringement, or a total of $1,750 in *Tempo Music, Inc. et al.* v. *International Good Music, Inc.,* Civil Action No. 5548;

b) $350 for each infringement, or a total of $21,000 in *Irving Berlin, et al.* v. *International Good Music, Inc.,* Civil Action No. 5773;

c) $350 for each infringement, or a total of $25,200 in *Cole Porter, et al.* v. *Rogan Jones and International Good Music, Inc.,* Civil Action No. 242 (Bellingham), both defendants to be jointly liable for all such damages;

d) $250 for each infringement, or a total of $1,000 in *Gershwin Publishing Corporation et al.* v. *K-91, Inc.,* Civil Action No. 5571;

e) $250 for each infringement, or a total of $3,500 in *Irving Berlin, et al.* v. *Wescoast Broadcasting Co.,* Civil Action No. 2258; and

f) $250 for each infringement or a total of $7,000 in *Betty Comden, et al.* v. *Wescoast Broadcasting Co.,* Civil Action No. 2415.

21. Plaintiffs are also entitled to reasonable attorneys' fees, as part of the costs. The attorneys' fees are fixed in the amount of $15,000 to be allocated among the cases in accordance with the amount of statutory damages allowed in each case.

Findings of Fact and Conclusions of Law

22. Plaintiffs are also entitled to an injunction restraining defendants from future infringement of plaintiffs' copyrighted musical compositions.

/s/ Gus J. Solomon
U. S. D. J.

Dated: January 18, 1965

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest: Harold W. Anderson
Clerk, U. S. District Court
Western District of Washington

By Betty Roughton
Deputy Clerk

[Seal]

Appendix B

Chapter 19.24

COPYRIGHT PROTECTION

Sections

19.24.010 Performance, selling, of copyrighted music or drama forbidden, when.
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19.24.230 Receiver—Attorney—Fees.

Appendix B

19.24.010 *Performance, selling, of copyrighted music or drama forbidden, when.* It shall be unlawful for any person who, without the consent of the owner thereof, shall cause to be publicly performed for profit any dramatic composition, or dramatic musical composition commonly called an opera, or other copyrighted works, or any substantial part thereof, which has been copyrighted under the laws of the United States, or for any person to knowingly participate in the performance or representation of any substantial part thereof, or by knowingly selling a substantial copy or any substantial part thereof. [1937 c 218 § 2; RRS § 3802-1.]

19.24.020 *Unlawful combinations—Per piece royalties—Parting with right to restrict use.* It shall be unlawful for two or more persons holding or claiming separate copyrighted works under the copyright laws of the United States, either within or without the state, to band together, or to pool their interests for the purpose of fixing the prices on the use of said copyrighted works, or to pool their separate interests or to conspire, federate, or join together, for the purpose of collecting fees in this state, or to issue blanket licenses in this state, for the right to commercially

use or perform publicly their separate copyrighted works: *Provided, however,* Such persons may join together if they issue licenses on rates assessed on a per piece system of usage: *Provided, further,* This chapter shall not apply to any one individual author or composer or copyright holder or owner who may demand any price or fee he or she may choose for the right to use or publicly perform his or her individual copyrighted work or works: *Provided, further,* Such per piece system of licensing must not be in excess of any per piece system in operation in other states where any group or persons affected by this chapter does business, and all groups and persons affected by this chapter, are prohibited from discriminating against the citizens of this state by charging higher and more inequitable rates per piece for music licenses in this state than in other states: *Provided, further,* Where the owner, holder, or person having control of any copyrighted work has sold the right to the single use of said copyrighted work, where its sole value is in its use for public performance for profit, and has received any consideration therefor, either within or without the state, then said person or persons shall be deemed to have sold and parted with the right to further restrict the use of said copyrighted work or works. [1937 c 218 § 3; RRS § 3802-2. Formerly RCW 19.24.020 and 19.24.030.]

19.24.030 *Copyright pools—Royalties on piece system.* [1937 c 218 § 3, part; RRS § 3802-2, part.] Now codified in RCW 19.24.020.

19.24.040 *Listing of pooled copyright works required.* In the event two or more persons holding separate copyrighted musical works, or any rights flowing therefrom, whether by assignment, agency agreements, or by any form of agreement, pool their interests, or combine, or conspire,

federate, or join together in any way, whether for a lawful purpose or otherwise, a complete list of their copyrighted works or compositions shall be filed once each year in the office of the secretary of state of the state of Washington, together with a list of the prices charged or demanded for their various copyrighted works; no payment or filing fee shall be required by the secretary of state, and said persons, corporations, or association, foreign or domestic shall state therein under oath, that said list is a complete catalogue of the titles of their claimed compositions, whether musical or dramatic or of any other classification, and in addition to stating the name and title of the copyrighted work it shall recite therein the date each separate work was copyrighted, and the name of the author, the date of its assignment, if any, or the date of the assignment of any interest therein, if any, and the name of the publisher, the name of the present owner, together with the addresses and residences of all parties who have at any time had any interest in such copyrighted work. The secretary of state shall require two copies of said list, one of which he shall keep on file, the other shall be forwarded to the office of the state treasurer at Olympia. [1937 c 218 § 4; RRS § 3802-3. FORMER PART OF SECTION: 1937 c 218 § 6; RRS § 3802-5, now codified as RCW 19.24.055.]

19.24.050 *Lists of copyrighted works—Open to public —Publication provided for.* The foregoing list of names and titles, provided for in the preceding section, shall be made available by the secretary of state to all persons for examination, in order that any user of copyrighted works in this state may know the rights and the titles to such copyrighted works as may be claimed by any of said combinations, pools, associations, or persons as aforesaid; said lists shall be prepared so that all persons may avoid using said copyrighted

compositions, if they so desire, and may avoid conflict therewith, and avoid committing innocent infringements of said works; and in order to further effectuate the copyright laws of the United States, the secretary of state shall, if he deems it necessary to protect the citizens of this state from committing innocent violations of the copyright laws of the United States, publish such list once each year in a newspaper of general circulation, in order that all citizens of the state may respect any and all individual rights granted by the United States copyright laws. [1937 c 218 § 5; RRS § 3802-4.]

19.24.055 *Filing required of nonresident and foreign copyright holders—Exception.* No person, corporation, or association, domestic or foreign, whether doing business in this state as hereinafter defined or not, shall be absolved from the foregoing duty of filing said list of holdings as required in the preceding sections of this chapter, if their music or copyrighted works are used commercially in this state, or have been used herein, whether originating from a point within the state or from without, and as long as any rendition thereof is received or heard within the state, or is intended to be so received by the originator of any musical program: *Provided, however,* Any individual owner of a copyrighted work or works, not a party to or not connected in any way with any pool, conspiracy, combination, or groups, or association of persons, as prohibited by this chapter, need not file any such list. [1937 c 218 § 6; RRS § 3802-5. Formerly RCW 19.24.040, part.]

19.24.060 *Declaration of purpose of legislation—Situs of copyrighted work.* It is hereby declared that the production and creation of music and the commercial use of music and of copyrighted works within this state, whether origi-

nating at a point from within or without the state, as long as the same shall be rendered and publicly received within the confines of this state, whether mechanically or by radio communication, is a business clothed and affected with the public interest, and the adult educational advantages engendered by the public use of music and in its creation, makes this business one of public necessity, and necessary for the education and training of the youth of this state; that many abuses are practiced under a false guise of federal protection which only the state with its police power can easily and lawfully restrain, and in order to prohibit, discourage, and prevent monopolistic practices, and to prevent extortion, to encourage free bargaining between the citizens of this state with each other and with those without the state, and in order to give greater effect to the constitutional provisions relating to monopoly and price fixing, and in the general interest of the public, therefore, the legislature in the interest of the peace and dignity of the state, in the interest of good morals and the general welfare of the people of this state, and for greater educational advantages to the public, declares that said business shall be subject to the police power and reasonable regulation of the state government, and such police and regulating power shall be administered by the courts and other officials of this state in a manner consistent with, in aid of, and never in conflict with, the copyright laws of the United States. The provisions of this chapter, and the administration thereof, shall at all times effectuate the enforcement, the true intent, and meaning of the United States copyright laws in order to prevent abuses from being practiced within this state from points within or from points without the state, by any individual, corporation, or organizations, who attempt to use the federal courts as innocent instrumentalities in the furtherance

of any systematic campaign or scheme designed to illegally fix prices for the commercial use of copyrighted works in this state through the use of extortionate means and terrorizing practices based on threats of suits, and an abuse of both state and federal process, all of which are declared to be in violation of this chapter and of the state Constitution; it is further declared that any person or persons, or combines, as aforesaid, who shall violate this chapter shall be deemed to have used their property within this state in such a way that the same shall have acquired a legal situs, analogous to the situs of other personal tangible property within the state, even though separate from the domicile and residence of the owner: *Provided, further,* The legal situs of any copyrighted work is coextensive about the state, and a copyrighted work used or sold for public use or public performance for profit, if intended to be heard from a point without the state or from a point within the state, is hereby declared to be a commercial commodity, and its legal situs is hereby declared to be within the state of Washington. [1937 c 218 § 7; RRS § 3802-6. Formerly RCW 19.24.060 through 19.24.090.]

19.24.070 *Declaration of police power.* [1937 c 218 § 7, part; RRS § 3802-6, part.] Now codified in RCW 19.24.060.

19.24.080 *Purpose of legislation.* [1937 c 218 § 7, part; RRS § 3802-6, part.] Now codified in RCW 19.24.060.

19.24.090 *Situs of copyrighted work.* [1937 c 218 § 7, part; RRS § 3802-6, part.] Now codified in RCW 19.24.060.

19.24.100 *Doing business defined—Amenability to process—Service on nonresidents.* All persons, groups,

corporations, associations, foreign or domestic, violating this chapter, shall be deemed to have been doing business within this state and amenable to the process of the state courts, when any such persons, combinations, or groups shall have issued licenses, either from within or from without the state, for the privilege of using commercially and publicly any copyrighted work or works pooled in a common group or entity, or when any of the functions of said entity, organization, pool, or combine, is or has been performed in this state; and the business of spying upon and the warning of users of the copyrighted works of such combinations, in addition to the presence within the state of such persons, and the activities of such persons or their agents at any time or occasion for the detection of infringements within this state, shall be conclusive evidence that such combinations and persons, even though nonresidents, have accepted the privileges of doing business within this state, and such persons, if they abide by the provisions of this chapter, shall be granted the privilege of conducting business within this state in a legal manner, and may invoke the benefits of the state government and its political subdivisions in their behalf, and they may use all of the privileges available to the citizens of this state in general, and the use at any time of any general privilege available to any citizen of this state, by any of such agents, their attorneys, or representative, or investigator, or by any aider and abettor, or any nonresident person, group, entity, or combination as aforesaid, shall be deemed to be an acceptance of the provisions of this chapter; and all licensees of any violator of this chapter shall be deemed as aiders and abettors of said persons and subject to the provisions of this chapter unless they forthwith indicate their obedience herewith; and the acceptance of the general

privileges of the state of Washington by any nonresident copyright holder or owner, or combination, defendant, or person, or organization of any kind, or entity, through an investigator, attorney, agent, representative, or through any aider and abettor as herein defined, and the acceptance by such persons of the rights, police protection, or of any general privilege conferred by the law of this state to any of its citizens, including the use of the roads and highways, or the privileges of any of its political subdivisions, as evidenced by their presence within the state at any time, shall be deemed equivalent to and construed to be an appointment by such nonresident or nonresidents, as the case may be, of the secretary of state of the state of Washington to be his or their true and lawful attorney upon whom may be served all summons and processes against him or them and growing out of a violation of this chapter, in which said nonresident may be involved, and said acceptance of the privileges of this state, as aforesaid, shall be a signification of his or their agreement that any summons or process against him or them which is so served shall be of the same legal force and validity as if served on him or them personally within the state of Washington. Service of such summons or process shall be made by leaving a copy thereof with a fee of two dollars with the secretary of the state of Washington, or in his office, and such service shall be sufficient and valid personal service upon any such nonresident defendant, copyright holder or owner, persons, or defendants, combination, entity, or organization, as aforesaid: *Provided,* That notice of such service and a copy of the summons of process shall be forthwith sent by registered mail requiring personal delivery, by the prosecutor bringing any action under this chapter, to any defendant at his last known address, and the defendant's return re-

ceipt and the prosecutor's affidavit of compliance herewith are appended to the process and entered as a part of the return thereof: *Provided, further,* The court in which any action is brought may order such continuances as may be necessary to afford any nonresident defendant or groups, or entity, a reasonable opportunity to defend the action: *Provided, further,* The secretary of state shall keep a record of all such summons and process which shall show the day and time of service; and valid personal service shall thus be had on nonresident persons or individuals, entities, firms, or corporations violating this chapter. [1937 c 218 § 8; RRS § 3802-7. Formerly RCW 19.24.100 through 19.24.130.]

19.24.110 *Doing business in this state—Evidence of.* [1937 c 218 § 8, part; RRS § 3802-7, part.] Now codified in RCW 19.24.100.

19.24.120 *Process—Secretary of state as agent.* [1937 c 218 § 8, part; RRS § 3802-7, part.] Now codified in RCW 19.24.100.

19.24.130 *Process—Service upon nonresident.* [1937 c 218 § 8, part; RRS § 3802-7, part.] Now codified in RCW 19.24.100.

19.24.140 *Injunction—Receivership—Anti-monopoly board—Escheat.* In the event any person, or groups of persons, or any combination or pool as aforesaid, whether a nonresident corporation, person, or an association, or domestic, refuse to abide by the provisions hereof, or attempt to evade or render ineffectual the true enforcement of any provision of this chapter, then the prosecuting attorney of any county where complaint is made of any violation, shall institute injunction proceedings against said

persons in the superior court, and valid personal service may be had upon any nonresident defendant as set forth in RCW 19.24.100; and the court shall enjoin all persons from violating the provisions of this chapter and the constitutional provisions prohibiting price fixing, monopolies, and combinations, and all copyrighted works and the public performance rights thereto when sold or used for profit are hereby declared to be a commercial commodity, and all persons, aiders and abettors, and agents, shall be enjoined by the court from aiding or furthering in any way a continuation of any violation of this chapter, either by the payment of money to said defendants or in any way; and if any defendant or defendants persist in defying the judgment of the court, the court shall, in order to effectuate its judgment and orders, order three days' notice to be given said defendant or defendants, as the case may be, by having a copy of such notice served on the secretary of state as heretofore provided if defendants are without the state, or served personally if within the state, and have the same published in some daily paper in the state of general circulation, and at the end of said period, if any defendant or defendants refuse to obey the order of the court, then the court shall appoint the county auditor as receiver for the copyrighted works and property of defendants, tangible or intangible, and of all other effects and moneys derived therefrom, and the receiver shall take over and preserve the commercial rights to all of said copyrighted works, together with such other property of any defendant, combination, pool, corporation, or entity through which they are acting, that he can locate within the state, and the receiver shall administer the same under the direction of the court, and said receivership shall be considered only as an incident to the main injunction suit

of the prosecutor, and for the purpose of enforcing the court's orders; the said receiver shall seize the copyrighted works of all of the copyright holders and owners in said defendant combination, including all of the rights to suits for infringement and damages in both state and federal courts, and all choses of action, and all sums due on contracts and licenses, and hold the same subject to the order of the court; and all persons holding licenses or contracts with any defendant combination or entity, shall pay the fees and sums due thereon to the receiver for such time as the court may need to effectuate the provisions of this chapter, and to compel any defendant to abide herewith: *Provided,* Any sums paid on licenses violating this chapter shall only be continued in the court's discretion or until such time as the court can award defendants complete and full due process of law before entering a final order thereon, or until such time as a legal and equitable system of licensing can be determined according to the subsequent provisions of this chapter: *Provided further,* In the event any defendant or defendants attempt to withdraw their said copyright works or property from the state in order to violate and render this chapter or the court's order ineffectual, or to deprive the citizens of this state of such commodity, or to hamper the enforcement of any provision of this chapter, or to injure any citizen or user of music in any way, then the court shall immediately order the receiver to compile a complete list of all of the copyrighted works of said defendants which have been used in this state, and the court shall then convene the state anti-monopoly board, as herein now created, consisting of the state treasurer and the state auditor, and said board shall meet in the county where the suit is filed, and the superior judge hearing the cause shall be an advisory member of said board; and said board, of

which the state treasurer shall be chairman, shall have only one function, the discouragement of price fixing and monopolies, and the court shall then submit to said board the single question of the establishment of license rates for the use of those copyrighted works controlled by the defendants so proceeded against; and for the purpose of aiding in the abolition of monopolies and price fixing, and preventing violations of this chapter, the board shall determine a fair and just rate that the receiver should charge for the single and separate public performance for profit of each copyrighted work or works of said defendants, on a per piece system and basis of licensing, and the court shall not be deemed thereby to have divested itself of any of its jurisdiction by so doing; after determining such rate, the said anti-monopoly board shall immediately advise the receiver of its findings, and of its fair rate, and the same shall be filed of record in the cause, and the receiver may then, if said finding is approved by the court, issue licenses for the use of said music at such approved rate on a basis of so much money per each time a piece of music is played or used in a public performance for profit; that said property shall be thus administered by the receiver for a period of one year, or until such time as the defendants, or the individual copyright owners of any combination so proceeded against take oath that they will abide by the rulings of the court and the provisions of this chapter; and all fees and funds collected by the receiver shall be turned over to the state treasurer, and no receiver's fees or attorney's fees shall be allowed, and the prosecuting attorney shall be the attorney for the receiver, and the state treasurer shall keep said money in a separate and special fund, subject to the order of the court only for whatever portion thereof that the court may order used to defray the actual expenses of the

board and the receivership; at the end of one year, if the defendants and copyright owners or holders in any combination thus proceeded against, continue to wilfully disobey the court's orders, then the court shall issue an order, which shall be published in three public places, to the effect that unless the defendants obey all of the orders of the court within ten days from the date of said order, that the court will proceed to permanently deprive said defendants and each of them of their property; and the court shall then order said defendants to show cause within ten days why they should not be involuntarily compelled to assign all of their copyrighted works to the receiver forthwith, and to show cause why all of the funds as collected in the manner aforesaid from licenses, together with all of the copyrighted works including the performing rights thereto of said defendants and members of said combine, should not escheat and be forfeited forever to the state of Washington, and be subject thereafter to administration by the state in the same manner as all other personal property belonging to the state of Washington; if any of said defendants and copyright holders, or owners, do appear before the end of said ten day period, and take oath that they will abide by the future orders of the court and the provisions of this chapter, then the court shall release their copyrighted works and order the state treasurer to return any and all of their money which has been received or seized: *Provided, however,* The court shall retain such jurisdiction over their persons for such time as the court may deem necessary to insure strict compliance with the terms of the court's judgment and the provisions of this chapter; if any of said defendants or copyright owners or holders shall ignore or refuse to obey the show cause order, as aforesaid, or fail to appear at the end of ten days as ordered

and abide by the court's judgment, then the court shall make an order and enter judgment to the effect that all of the copyrighted works, including the performing rights thereto, of said defendants and the members of any defendant combination, shall be construed as having been escheated and forfeited to the state of Washington, and the court shall thereupon appoint some officer of the court to execute an involuntary assignment of all the legal and equitable titles to all of the copyrighted works of each of each of said defendants and members of any defendant combination to the receiver, in the event the defendants or any of their members fail to execute a voluntary assignment, and the receiver shall immediately file said involuntary assignment at the United States Copyright Office at Washington, D. C.; and the court shall then order the receiver to close the estate, and turn the titles to said copyrighted works over by proper assignment from the receiver to the state treasurer of the state of Washington, who shall thereafter administer, issue licenses for the use of the same in a manner consistent with this chapter, and conserve the same as state personal property in his possession, and according to law; and any funds left in the state treasury from said receivership shall escheat and be forfeited to the state and become part of the general fund: *Provided, further,* The state treasurer shall make a report to the legislature on each biennium of the amount of money received from such licensing and the amount of property he has on hand through the enforcement of this chapter. [1937 c 218 § 9; RRS § 3802-8. Formerly RCW 19.24.140 through 19.24.270.]

Appendix B

19.24.150 *Injunction—To whom to be applicable.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.160 *Injunction — Enforcement — Receiver.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.170 *Receivership—Scope.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.180 *Receivership—Collection of disputed license fees.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.190 *Anti-monopoly board — Convening by court, when.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.200 *Anti-monopoly board — Membership — Duties.* [1937 c 218 § 9, parts; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.210 *Receiver—License fees fixed by board.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.220 *Receiver—Term of administration.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.230 *Receiver—Attorney—Fees.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

Appendix B

19.24.240 *Escheat of copyrights to state—Order to show cause.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.250 *Escheat of copyrights—Procedure.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.260 *Escheat—Recording by receiver—Disposition.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.270 *Escheted property—Biennial reports by treasurer.* [1937 c 218 § 9, part; RRS § 3802-8, part.] Now codified in RCW 19.24.140.

19.24.280 *Special appearances deemed general.* That in the event any person, or any of the defendants, or nonresidents, or nonresident copyright owners or holders, are proceeded against as herein outlined, and are served with process according to law, or any nonresident is served with process as outlined in the preceding sections of this chapter, and if any of said defendants, or persons, or aiders and abettors named as defendants, appear in any such proceeding by counsel or otherwise, or institute any special proceeding attacking such proceeding, or make any motion therein, either special or general, or if any of them appear to obtain the judgment of the court solely upon the sufficiency of the service of process upon them, or upon any phase or particularity of said injunction proceedings, such special proceeding or appearance, or motion, or appearance, as the case may be, shall nevertheless be deemed as a general appearance even though the process may have been insufficient, and said parties and defendants as may

thus appear in the action, for any reason or cause, whether they seek special or affirmative relief, shall thereafter be subject to the general orders and jurisdiction of the court for all purposes, and if any of said defendants or persons appear in any court proceeding instituted to effectuate this chapter solely for the purpose of challenging the validity of service of process upon them they shall be deemed to have surrendered themselves and as having submitted to the general jurisdiction of the court: *Provided, however,* This section shall not be construed as denying, and no attempt shall be made at any time in any proceeding in connection with the enforcement of this chapter, to restrain or deny any of said defendants, resident or non-resident, copyright holders or owners, or any person or members of any defendant combination, entity, pool, or monopoly of their rights or property without full and complete due process of law. [1937 c 218 § 10; RRS § 3802-9.]

19.24.290 *Violations—Penalties.* Every person, in addition to the other penalties provided in this chapter, who violates or who procures, or aids or abets in the violating of any provision of this chapter, or who conspires to render ineffectual any valid order or decision of any court in the enforcement of this chapter, or who procures, conspires with, or aids or abets any person or persons in his or their failure to obey the provisions of this chapter, or to render ineffectual any valid order of any court in connection with the enforcement of this chapter shall be deemed guilty of a gross misdemeanor, and upon conviction, shall be punished by a fine not exceeding five hundred dollars, or imprisonment in the county jail for not more than six months, or both such fine and imprisonment. [1937 c 218 § 11; RRS § 3802-10.]

Appendix B

19.24.300 *Concurrent injunctions or receiverships.* In the event more than one injunction suit provided for in this chapter is instituted in this state, in different counties by different prosecuting attorneys, but against the same defendants, the respective superior judges hearing the causes may issue orders against said defendants in any county, but in the event any of the various county proceedings enter into the state of receivership, as herein provided, then the judges hearing the respective causes shall order those causes where the defendants are the same, to be consolidated in one action in one particular county, and in such county as the judges may decide, to the end that only one receiver may be appointed for the entire state of the property of the same defendant or defendants. [1937 c 218 § 13; RRS § 3802-12.]

19.24.900 *Severability—General repealer.* In case any part or portion of this chapter shall be held unconstitutional, such holding shall not affect the validity of this chapter as a whole or any other part or portion of this chapter, and if any clause, sentence, paragraph, subdivision, section or part of this chapter shall for any reason be adjudged invalid, such judgment shall not affect, impair or invalidate the remainder of the chapter, but shall be strictly confined in its operation and holding to the specific clause, sentence, paragraph, subdivision, section, or part thereof, directly involved in the controversy in which such judgment shall have been rendered; and all other acts and laws in conflict herewith are hereby repealed. [1937 c 218 § 12; RRS § 3802-11.]

Appendix C

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, *Plaintiff*, v. AMERICAN SOCIETY OF COMPOSERS, AUTHORS AND PUBLISHERS, et al., *Defendants.*	Civil Action No. 13-95 AMENDED FINAL JUDGMENT

Plaintiff having filed its complaint herein on February 26, 1941, the defendants having appeared and filed their answer to the complaint denying the substantive allegations thereof, all parties having consented, without trial or adjudication of any issue of fact or law therein, to the entry of a Civil Decree and Judgment, filed March 4, 1941, and jurisdiction having been retained in this Court pursuant to Section VI of said Civil Decree and Judgment for the purpose of granting such modifications of the Civil Decree and Judgment as may be necessary and appropriate; and

Plaintiff having moved the Court that said Civil Decree and Judgment should be modified in certain respects, and all parties hereto consenting to such modifications and the entry of this Amended Final Judgment,

Now, THEREFORE, no testimony having been taken and without trial or adjudication of any issue of fact or law herein and without admission by any defendant in respect of any such issue and upon consent of all parties hereto, it is hereby

ORDERED, ADJUDGED AND DECREED that the Civil Decree and Judgment of March 4, 1941 be amended to read as follows:

I. This Court had jurisdiction of the subject matter hereof and of all parties hereto with full power to enter this Judgment. The complaint states a cause of action against the defendants under Section 1 of the Act of Congress of July 2, 1890, entitled "An Act to Protect Trade and Commerce Against Unlawful Restraints and Monopolies," commonly known as the Sherman Act, as amended.

II. As used in this Judgment:

(A) "ASCAP" means the defendant American Society of Composers, Authors and Publishers;

(B) "Right of public performance" means the right to perform a copyrighted musical composition publicly for profit in a non-dramatic manner, sometimes referred to as "small performing right";

(C) "Motion picture performance right" means the right of public performance of music which is recorded in order to be performed in synchronism or timed relation to the exhibition of motion pictures;

(D) "ASCAP repertory" means those compositions the right of public performance of which ASCAP has or hereafter shall have the right to license or sublicense;

(E) "User" means any person, firm or corporation who or which (1) owns or operates an establishment or enterprise where copyrighted musical compositions are performed publicly for profit, or (2) is otherwise directly engaged in giving public performance of copyrighted musical compositions for profit, or (3) is entitled to obtain a license from ASCAP under Section V of this Judgment.

III. The provisions of this Judgment applicable to the defendant ASCAP shall apply to such defendant, its successors and assigns, and to each of their officers, directors, agents, employees, and to all other persons, including members, acting or claiming to act under, through or for such defendant. None of the injunctions or requirements herein imposed upon the defendants shall apply to the acquisition of or licensing of the right to perform musical compositions publicly for profit outside the United States of America, its territories or possessions, such acquisition or licensing being subject to the provisions of the Final Judgment entered this day in Civil Action No. 42-245.

IV. Defendant ASCAP is hereby enjoined and restrained from:

(A) Holding, acquiring, licensing, enforcing, or negotiating concerning any rights in copyrighted musical compositions other than rights of public performance on a non-exclusive basis;

(B) Limiting, restricting, or interfering with the right o

any member to issue to a user non-exclusive licenses for rights of public performance;

(C) Entering into, recognizing, enforcing or claiming any rights under any license for rights of public performance which discriminates in license fees or other terms and conditions between licensees similarly situated;

(D) Hereafter granting any license for rights of public performance in excess of five years' duration, except for motion picture performance rights which are licensed pursuant to Section V (C) of this Judgment;

(E) Granting to, enforcing against, collecting any monies from, or negotiating with any motion picture theatre exhibitor concerning any motion picture performance rights;

(F) Instituting or threatening to institute, or maintaining or continuing any suit or proceeding (1) against any motion picture theatre exhibitor for copyright infringement relating to motion picture performance rights or (2) against any user for copyright infringement of any musical composition not contained in the ASCAP repertory. After the preparation of the list required to be maintained by Section XIV herein, the repertory shall be deemed to consist of only those compositions appearing on such list;

(G) Restricting the right of any member to withdraw from membership in ASCAP at the end of any fiscal year upon (1) giving three months' advance written notice to ASCAP, and (2) agreeing that his resignation shall be subject to any rights or obligations existing between ASCAP and its licensees under then existing licenses and to the rights of the withdrawing member accruing under such licenses;

(H) Asserting or exercising any right or power to restrict from public performance for profit by any licensee of ASCAP any composition in order to exact additional consideration for the performance thereof, or for the purpose of permitting the fixing or regulating of fees for the recording or transcribing of such composition. Nothing in this Subsection shall be construed to prevent ASCAP, when so directed by the member in interest in respect of a musical composition, from restricting performances of a composition in order reasonably to protect the composition against indiscriminate performances, or the

value of the public performance for profit rights therein, or the dramatic performing rights therein, or to prevent ASCAP from restricting performances of a composition so far as may be reasonably necessary in connection with any claim or litigation involving the performing rights in any such composition.

V. Defendant ASCAP is hereby ordered and directed to issue, upon request, licenses for rights of public performance of compositions in the ASCAP repertory as follows:

(A) To a radio broadcasting network, telecasting network or wired music service (as illustrated by the organization known as "Muzak"), on terms which authorize the simultaneous and so-called "delayed" performance by broadcasting or telecasting, or simultaneous performance by wired music service, as the case may be, of the ASCAP repertory by any, some or all of the stations in the United States affiliated with such radio network or television network or by all subscriber outlets in the United States affiliated with any wired music service and do not require a separate license for each station or subscriber for such performances;

(B) To a manufacturer, producer or distributor of a transcription or recordation of a composition in ASCAP's repertory which is or shall be recorded for performance on specified commercially sponsored radio programs or television programs, as the case may be, on an electrical transcription or on other specially prepared recordation intended for radio broadcasting or for television broadcasting purposes (or to any advertiser or advertising agency on whose behalf such transcription or recordation shall have been made) of the right to authorize the broadcasting, by radio or by television, as the case may be, of the recorded composition by means of such transcription or recordation by all radio stations or television stations in the United States enumerated by the licensee, without requiring separate licenses for such enumerated stations for such performance;

(C) To any person engaged in producing motion pictures (herein referred to as a "motion picture producer"), so long as ASCAP shall not have divested itself of such rights, a single license of motion picture performance rights covering the United States, its territories and possessions, without requiring further licenses. Such single license shall be issued in accordance with

the following requirements and in accordance with all other provisions of this Judgment not inconsistent therewith:

(1) Such license shall be limited to pictures produced or in production not later than one year after the effective date of the license, and shall not make any charge for any performance occurring prior to the date of this Judgment;

(2) Upon written request of any motion picture producer such licenses shall be issued on a "per film" basis for the compositions in such film which are in the ASCAP repertory;

(3) All licenses of motion picture performance rights under this Subsection (C) shall be negotiated with and issued to individual motion picture producers, and not on an "industry-wide" basis;

(4) Where within a period of nineteen (19) months prior to the entry of this Judgment a motion picture producer has obtained a license for motion picture performance rights directly from members of ASCAP and has paid a separately stated amount therefor, such licenses issued by ASCAP covering motion picture performance rights shall, at the request of such producer, include the rights conveyed by the previous license, in which event ASCAP shall allow the motion picture producer a credit against the amount otherwise payable, equal to the amount paid under the previous license;

(5) No writer or publisher member of the Board of Directors of ASCAP shall participate in or vote on any question relating to the negotiation, execution, performance or enforcement of any such license where such member at the time, directly or indirectly, has any pecuniary interest in any motion picture producer, in any subsidiary or affiliate of any motion picture producer, or in any contractual relationship with any such producer.

VI. Defendant ASCAP is hereby ordered and directed to grant to any user making written application therefor a non-exclusive license to perform all of the compositions in the ASCAP repertory. Defendant ASCAP shall not grant to any user a license to perform one or more specified compositions in the ASCAP repertory, unless both the user and member or members in interest shall have requested ASCAP in writing so to do, or unless ASCAP, at the written request of the prospec-

tive user shall have sent a written notice of the prospective user's request for a license to each such member at his last known address, and such member shall have failed to reply within thirty (30) days thereafter.

VII. Defendant ASCAP, in licensing rights for public performance for radio broadcasting and telecasting, is hereby:

(A) Enjoined and restrained from issuing any license, the fee for which

> (1) in the case of commercial programs, is based upon a percentage of the income received by the licensee from programs which include no compositions in the ASCAP repertory, or
>
> (2) in the case of sustaining programs, does not vary in proportion either (a) to the performance of compositions in the ASCAP repertory during the term of the license, or (b) to the number of programs on which such compositions or any of them are performed,

unless the radio broadcaster or telecaster to whom such license shall be issued shall desire a license on either or both of such bases;

(B) Ordered and directed to issue to any unlicensed radio or television broadcaster, upon written request, per program licenses, the fee for which

> (1) in the case of commercial programs, is, at the option of ASCAP, either (a) expressed in terms of dollars, requiring the payment of a specified amount for each program in which compositions in the ASCAP repertory shall be performed, or (b) based upon the payment of a percentage of the sum paid by the sponsor of such program for the use of the broadcasting or telecasting facilities of such radio or television broadcaster,
>
> (2) in the case of sustaining programs, is at the option of ASCAP, either (a) expressed in terms of dollars, requiring the payment of a specified amount for each program in which compositions in the ASCAP repertory shall be performed, or (b) based upon the payment of a percentage of the card rate which would have been applicable for the use of its broadcasting facilities in

connection with such program if it had been commercial, and

(3) subject to the other provisions of Section VIII, takes into consideration the economic requirements and situation of those stations having relatively few commercial announcements and a relatively greater percentage of sustaining programs, with the objective that such stations shall have a genuine economic choice between per program and blanket licenses;

(C) Enjoined and restrained from requiring or influencing the prospective licensee to negotiate for a blanket license prior to negotiating for a per program license.

VIII. Defendant ASCAP, in fixing its fees for the licensing of compositions in the ASCAP repertory, is hereby ordered and directed to use its best efforts to avoid any discrimination among the respective fees fixed for the various types of licenses which would deprive the licensees or prospective licensees of a genuine choice from among such various types of licenses.

IX. (A) Defendant ASCAP shall, upon receipt of a written application for a license for the right of public performance of any, some or all of the compositions in the ASCAP repertory, advise the applicant in writing of the fee which it deems reasonable for the license requested. If the parties are unable to agree upon a reasonable fee within sixty (60) days from the date when such application is received by ASCAP, the applicant therefor may forthwith apply to this Court for the determination of a reasonable fee and ASCAP shall, upon receipt of notice of the filing of such application, promptly give notice thereof to the Attorney General. In any such proceeding the burden of proof shall be on ASCAP to establish the reasonableness of the fee requested by it. Pending the completion of any such negotiations or proceedings, the applicant shall have the right to use any, some or all of the compositions in the ASCAP repertory to which its application pertains, without payment of any fee or other compensation, but subject to the provisions of Subsection (B) hereof, and to the final order or judgment entered by this Court in such proceeding;

(B) When an applicant has the right to perform any compositions in the ASCAP repertory pending the completion of any negotiations or proceedings provided for in Subsection (A)

hereof, either the applicant or ASCAP may apply to this Court to fix an interim fee pending final determination of what constitutes a reasonable fee. If the Court fixes such interim fee, ASCAP shall then issue and the applicant shall accept a license providing for the payment of a fee at such interim rate from the date of the filing of such application for an interim fee. If the applicant fails to accept such license or fails to pay the interim fee in accordance therewith, such failure shall be ground for the dismissal of his application. Where an interim license has been issued pursuant to this Subsection (B), the reasonable fee finally determined by this Court shall be retroactive to the date the applicant acquired the right to use any, some or all of the compositions in the ASCAP repertory pursuant to the provisions of this Section IX;

(C) When a reasonable fee has been finally determined by this Court, defendant ASCAP shall be required to offer a license at a comparable fee to all other applicants similarly situated who shall thereafter request a license of ASCAP, but any license agreement which has been executed without any Court intervention between ASCAP and another user similarly situated prior to such determination by the Court shall not be deemed to be in any way affected or altered by such determination for the term of such license agreement;

(D) Nothing in this Section IX shall prevent any applicant or licensee from attacking in the aforesaid proceedings or in any other controversy the validity of the copyright of any of the compositions in the ASCAP repertory nor shall this Judgment be construed as importing any validity or value to any of said copyrights.

X. No officer or director of ASCAP, or any person acting on its behalf, shall participate in or vote on any question relating to any transaction or negotiation involving ASCAP and a licensee, or prospective licensee, where such officer, director, or other person has any pecuniary interest in such licensee or prospective licensee, or in any subsidiary or affiliate thereof, or in any contractual relationship with any such licensee or prospective licensee.

XI. Defendant ASCAP is hereby ordered and directed to distribute to its members the monies received by licensing rights of public performance on a basis which gives primary considera-

tion to the performance of the compositions of the members as indicated by objective surveys of performances (excluding those licensed by the member directly) periodically made by or for ASCAP.

XII. Defendant ASCAP is hereby ordered and directed, within three months after the entry of this Judgment, to provide in its Articles of Association, effective as of the date of this Judgment, that ASCAP's members be prohibited from:

(A) At any time, while a member of ASCAP or thereafter, instituting, or threatening to institute, or maintaining or continuing any suit or proceeding for acts of copyright infringement relating to motion picture performance rights (1) alleged to have occurred prior to the date of this Judgment, or (2) where corresponding synchronization rights have been granted prior to the date of this Judgment;

(B) While a member of ASCAP, granting a synchronization or recording right for any musical composition to any motion picture producer unless the member or members in interest or ASCAP grants corresponding motion picture performance rights in conformity with the provisions of this Judgment.

XIII. In order to insure a democratic administration of the affairs of defendant ASCAP, and to assure its members an opportunity to protect their rights through fair and impartial hearings based on adequate information, defendant ASCAP is hereby ordered and directed to provide in its Articles of Association:

(A) That the members of the Board of Directors shall be elected by a membership vote in which all author, composer and publisher members shall have the right to vote for their respective representatives to serve on the Board of Directors. Due weight may be given to the classification of the member within ASCAP in determining the number of votes each member may cast for the election of directors. Elections for the entire membership of the Board of Directors shall take place annually or every two years. The Board of Directors shall, as far as practicable, give representation to writer members and publisher members with different participations in ASCAP's revenue distributions;

(B) That the general basis of member classification for voting and revenue distribution purposes shall be set forth in

writing and shall be made available to any member upon request;

(C) That any member may appeal from the final determination of his classification by any ASCAP committee or board to an impartial arbiter or panel;

(D) That records be maintained by the officers, committees, or boards of ASCAP, and the impartial arbiters or panels referred to in Subsection (C) of this Section dealing with the classification of members and distribution of revenues, which will adequately apprise the respective members of the determinations made and actions taken by such officers, committees and boards of ASCAP, and arbiters or panels as to such members and the basis therefor.

XIV. Immediately following entry of this Judgment, defendant ASCAP shall upon written request from any prospective user inform such user whether any compositions specified in such request are in the ASCAP repertory, and make available for public inspection such information as to the ASCAP repertory as it has. Defendant ASCAP is furthermore ordered and directed to prepare within two years, and to maintain and keep current and make available for inspection during regular office hours, a list of all musical compositions in the ASCAP repertory, which list will show the title, date of copyright and the author, composer and current publisher of each composition.

XV. Defendant ASCAP is hereby ordered and directed to admit to membership, non-participating or otherwise,

(A) Any composer or author of a copyrighted musical composition who shall have had at least one work of his composition or writing regularly published;

(B) Any person, firm, corporation or partnership actively engaged in the music publishing business, whose musical publications have been used or distributed on a commercial scale for at least one year, and who assumes the financial risk involved in the normal publication of musical works.

XVI. For the purpose of securing compliance with this Amended Final Judgment, duly authorized representatives of the Department of Justice shall upon the written request of the Attorney General or an Assistant Attorney General, and on

reasonable notice to defendant, be permitted (a) reasonable access, during the office hours of said defendant, to all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under the control of said defendant, relating to any of the matters contained in this Amended Final Judgment; (b) subject to the reasonable convenience of said defendant and without restraint or interference from it, to interview officers or employees of said defendant, who may have counsel present, regarding any such matters; and said defendant, on such request, shall submit such reports in respect of any such matters as may from time to time be reasonably necessary for the proper enforcement of this Judgment, provided, however, that information received by the means permitted in this Section XVI shall not be divulged by any representative of the Department of Justice to any person other than a duly authorized representative of the Department of Justice, except in the course of legal proceedings in which the United States is a party or as otherwise required by law.

XVII. Jurisdiction of this cause is retained for the purpose of enabling any of the parties to this Amended Final Judgment to make application to the Court for such further orders and directions as may be necessary or appropriate in relation to the construction of or carrying out of this Judgment, for the modification thereof, for the enforcement of compliance therewith and for the punishment of violations thereof.

It is expressly understood, in addition to the foregoing, that the plaintiff may, upon reasonable notice, at any time after five (5) years from the date of entry of this Amended Final Judgment apply to this Court for the vacation of said Judgment, or its modification in any respect, including the dissolution of ASCAP (and any time within two (2) years from said date apply to this Court for the vacation or modification of Section V (C) hereof). During the applicable periods specified above, defendant ASCAP is hereby ordered and directed to conduct its affairs, including the making of agreements to acquire or license the rights of public performance, so as not unreasonably to complicate or delay the enforcement of any such further relief requested by plaintiff and granted by this Court pursuant to the terms of this Section.

XVIII. This Amended Final Judgment shall become effective from the date of entry hereof, except that the provisions of

Sections IV (G), XIII and XV shall become effective three months after the date of entry hereof, and the provisions of Section XI shall become effective eight months after the date of entry hereof. This Amended Final Judgment supersedes the Civil Decree and Judgment entered herein on March 4, 1941, but shall not be construed to make proper or lawful or sanction any acts which occurred prior to the date hereof which were enjoined, restrained or prohibited by said Civil Decree and Judgment of March 4, 1941.

Approved:

March 14, 1950

HENRY W. GODDARD
United States District Judge

We hereby consent to the entry of the foregoing Judgment.

For the plaintiff

SIGMUND TIMBERG
Special Assistant to the Attorney General

WILLIAM D. KILGORE, JR.

HAROLD LASSER
Special Attorneys

HERBERT A. BERGSON
Assistant Attorney General

MELVILLE C. WILLIAMS
Special Assistant to the Attorney General

IRVING H SAYPOL
United States Attorney

For the defendants

ROBERT P. PATTERSON

HERMAN FINKELSTEIN

OSCAR COX

Schwartz & Frohlich

By LOUIS D. FROHLICH

Judgment entered:

WILLIAM V. CONNELL
Clerk
March 14, 1950

Appendix D

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, *Plaintiff,* —*against*— AMERICAN SOCIETY OF COMPOSERS, AUTHORS AND PUBLISHERS, ET AL., *Defendants.*	Civil Action File No. 13-95
In the Matter of the Application of KBKW, INC., ET AL., *Petitioners,* For the Determination of License, Terms and Conditions.	PETITION

TO THE HONORABLE JUDGES OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK:

The petitioners respectfully allege:

1. The petitioners are the firms listed in Schedule A annexed to this petition (hereinafter called the "petitioners").

2. Petitioners are operators of radio and television stations located in the State of Washington. The call letters and location of the station or stations operated by each petitioner are set forth opposite their names on Schedule A. Said radio and television stations are operated pursuant to licenses granted by the Federal Communications Commission.

3. On March 14, 1950, this court entered its Amended Final Judgment in the action entitled "United States of America, Plaintiff, vs. American Society of Composers, Authors and Publishers, et al., Defendants" Civil Action No. 13-95 hereinafter referred to as ("ASCAP Final Judgment").

4. Section IX(A) of the Amended Final Judgment provides as follows:

> "(A) Defendant ASCAP shall, upon receipt of a written application for a license for the right of public performance of any, some or all of the compositions in the ASCAP repertory, advise the applicant in writing of the fee which it deems reasonable for the license requested. If the parties are unable to agree upon a reasonable fee within sixty (60) days from the date when such application is received by ASCAP, the applicant therefor may forthwith apply to this Court for the determination of a reasonable fee and ASCAP shall, upon receipt of notice of the filing of such application, promptly give notice thereof to the Attorney General. In any such proceeding the burden of proof shall be on ASCAP to establish the reasonableness of the fee requested by it. Pending the completion of any such negotiations or proceedings, the applicant shall have the right to use any, some or all of the compositions in the ASCAP repertory to which its application pertains, without payment of any fee or other compensation, but subject to the provisions of Subsection (B) hereof, and to the final order or judgment entered by this Court in such proceeding;"

5. Petitioners have made written application to the defendant, the American Society of Composers, Authors and Publishers, (hereinafter referred to as "ASCAP") for licenses for the right of public performance of the compositions in the ASCAP repertory by the stations operated by them within the State of Washington.

6. On March 20, 1959, this Court entered an order in this cause, paragraph 6 of which provides, in part, as follows:

> "The provisions of this order shall not be construed as directing the Society to issue interim licenses to radio stations located in the State of Washington. . . . in view of the provisions of the Revised Code of Washington C. 19.24 (1957)."

7. Since January 1, 1959, ASCAP has refused to grant licenses for the right of public performance of compositions in the ASCAP repertory by radio stations located in the State of Washington. With few exceptions, petitioners do not have such licenses for public performance by the radio stations listed in Schedule A annexed hereto.

8. ASCAP has refused to grant licenses for the right of public performance of compositions in the ASCAP repertory by certain television stations located in the State of Washington. Certain of the petitioners do not have such licenses for public performance by television stations listed in Schedule A annexed hereto.

Wherefore, petitioners respectfully apply to this court, on behalf of themselves and all others similarly situated who may join in this application, for an order and decree of this court:

(a) directing ASCAP to grant to petitioners and others similarly situated who may join herein, licenses for the right of public performance of compositions in the ASCAP repertory by the radio and television stations operated by them within the State of Washington;

(b) determining and establishing the terms and conditions of such licenses; and

(c) granting such other and further relief as to the court may seem just and proper

Dated this 20th day of November, 1959.

s/ Ronald A. Murphy
RONALD A. MURPHY
Attorney for Petitioners
Office and P. O. Address
3314 White-Henry-Stuart
Building
Seattle 1, Washington

Appendix D

Schedule of Petitioners

Petitioner	Call Letters	Location of [redacted] Station
BKW Inc.	KBKW	Aberdeen
XRO Inc.	KXRO	Aberdeen-Hoquiam
uburn Broadcasters Inc.	KASY	Auburn
ellevue Broadcasters	KFKF	Bellevue
PUG Inc.	KPUG	Bellingham
remerton Broadcasting Co. ...	KBRO	Bremerton
entral Broadcasting Corp. ...	KELA	Centralia-Chehalis
ITI Corp.	KITI	Centralia-Chehalis
ake Chelan Broadcasting Corp.	KOZI	Chelan
drian Devries	KCLX	Colfax
olville Broadcasting Co.	KCVL	Colville
estern Broadcasters Inc.	KXLE	Ellensburg
oulee Broadcasting Corp.	KULE	Ephrata
alter N. Nelskog	KQTY	Everett
verett Broadcasting Co.	KRKO	Everett
alph A. Nachtmann	KFDR	Grand Coulee
mes D. Higson	KLOG	Kelso-Longview
EPR Inc.	KEPR	Kennewick-Richland-Pasco
erguson & Hall	KFHA	Lakewood
riad Broadcasting Corp.	KEDO	Longview
SEM Inc.	KSEM	Moses Lake
entral Basin Broadcasting Corp.	KWIQ	Moses Lake
eckley Radio Co.	KBRC	Mount Vernon

Appendix D

Schedule of Petitioners

Petitioner	Call Letters	Location of [redacted] Station
Tom Olsen	KGY	Olympia
KITN Corp.	KITN	Olympia
KOMW Inc.	KOMW	Omak
KZUN Inc.	KZUN	Opportunity
Othello Radio	KRSC	Othello
KORD Inc.	KORD	Pasco
KPKW Radio	KPEW	Pasco
Radio Pacific Inc.	KONP	Port Angeles
Prosser-Grandview Broadcasters Inc.	KARY	Prosser
KOFE Inc.	KOFE	Pullman
Wash. State University	KWSC	Pullman
Quincy Valley Broadcasters	KPOR	Quincy
Willapa Broadcasting Co.	KAPA	Raymond
D & D Broadcasting Corp.	KALE	Richland
Wash. Telecasters Inc.	KAYO	Seattle
King Broadcasting Co.	KING	Seattle
Queen City Broadcasting Co. ...	KIRO	Seattle
Seattle Broadcasting Co.	KOL	Seattle
Fisher's Blend Station Inc.	KOMO	Seattle
KTIX Inc.	KTIX	Seattle
Golden West Broadcasters	KVI	Seattle
KXA Inc.	KXA	Seattle

Appendix D

Schedule of Petitioners

Petitioner	Call Letters	Location of [redacted] Station
KMQ Inc.	KHQ	Spokane
KLYK Inc.	KYYK	Spokane
Northern Pacific Radio Corp. ..	KXYL	Spokane
Cole E. Wylie	KREW	Sunnyside
Tacoma Radio Corp.	KMO	Tacoma
Tacoma Broadcasters Inc.	KTAC	Tacoma
Tribune Publishing Co.	KTNT	Tacoma
Radio Broadcasters Inc.	KENE	Toppenish
Leader Broadcasting Co.	KHIT	Walla Walla
Walla Walla Broadcasting Co. ..	KTEL	Walla Walla
Frontier Broadcasting Co.	KMEL	Wenatchee
KUEN Broadcasting Co.	KUEN	Wenatchee
Cascade Broadcasting Co.	KIMA	Yakima
KIT Inc.	KIT	Yakima
Yakima Broadcasting Corp. ...	KLOQ	Yakima
KREM Broadcasting Co.	KREM	Spokane
Basin TV Co.	KBAS-TV	Ephrata
Cascade Broadcasting Co.	KEPR-TV	Pasco
KHQ Inc.	KHQ-TV	Spokane
KREM Broadcasting Co.	KREM-TV	Spokane
Northern Pacific Television Corp.	KXYL-TV	Spokane
J. Elroy McCaw	KTVW	Tacoma
Cascade Broadcasting Co.	KIMA-TV	Yakima

Appendix E

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

<table>
<tr><td>UNITED STATES OF AMERICA,
Plaintiff,
—against—

AMERICAN SOCIETY OF COMPOSERS, AUTHORS AND PUBLISHERS, ET AL.,
Defendants.</td><td rowspan="2">Civil Action No. 13-95

ORDER</td></tr>
<tr><td>In the Matter of the Application of
KBKW, INC., ET AL.,
Petitioners,
For the Determination of Reasonable License Fees.</td></tr>
</table>

Petitioners KBKW, Inc., et al., having applied to the Court for determination of a reasonable license fee pursuant to Section IX of the Amended Final Judgment herein, and the respondent, American Society of Composers, Authors and Publishers, having refused to issue licenses to certain radio stations located in the State of Washington, and certain petitioners having likewise refused to accept licenses, and petitioners desiring licenses from the respondent to use all the compositions in the respondent's repertory and the respondent desiring to issue such licenses to petitioners, and the petitioners and respondent, having agreed with the aid of the Court, upon forms of license agreements for the period commencing January 1, 1959, subject to modification as herein provided; and upon the disposition

of claims for the period prior thereto, and the Court having taken into consideration the following unusual circumstances presented upon this application:

(a) that a statute was enacted in the State of Washington in 1937 (Revised Code c.19.24—Laws 1937 c.218) making it unlawful for combinations of copyright owners to issue licenses in the State of Washington for the right of public performance of their copyrighted works except on a per piece basis, but providing further that the act shall not apply to any one individual author, composer or copyright owner;

(b) that subsequent to 1937, an Amended Final Judgment was entered in this action on March 14, 1950 regulating the licensing activities of the respondent by directing respondent to issue a license to any user who shall apply therefor, and requiring that such licenses shall not discriminate in license fees or other terms and conditions between licensees similarly situated;

(c) that the said Amended Final Judgment bars respondent from licensing individual compositions or quoting prices to users for the use of individual compositions unless the member of respondent in interest and the user shall both request respondent to do so;

(d) that members of respondent are free to grant individual licenses to any user in the State of Washington who may prefer to deal with such individual members instead of dealing with respondent;

(e) that petitioners desire a license from respondent to use the compositions in respondent's repertory without limitation to individual works and without negotiating

with the individual members—such licenses to be made available by respondent on substantially the same terms as such licenses are made available for the period commencing January 1, 1959 to owners and operators of broadcasting stations in other states;

(f) that there has been a great deal of confusion in the past because of the uncertainty of petitioners and defendant as to their respective rights and obligations under the Copyright Law of the United States, the statutes of the State of Washington, and the requirements of this Amended Final Judgment;

(g) that it is in the interest of petitioners and other users of copyrighted musical compositions in the State of Washington as well as of the defendant and the public at large that this matter be resolved within the framework of the Amended Final Judgment;

and the owners of certain broadcasting stations in states other than Washington having filed a petition in this Court for the determination of reasonable license fees in the proceeding entitled "In the Matter of the Application of The Marion Broadcasting Co., et al., Petitioners for the Determination of Reasonable License Fees" (hereinafter referred to as the Marion proceeding) and petitioners herein and the respondent being desirous of entering into agreements for the period commencing January 1, 1959, upon the same basis as shall be available to petitioners in the Marion proceeding, other than provisions relating to arbitration of disputes, the law applicable to the agreements, and the disposition of claims for the period prior to January 1, 1959, and petitioners and defendant, having consented to the entry of this order and notice of hearing hav-

ing been given to the United States of America and to the attorneys for the petitioners in the Marion proceeding.

It is hereby ordered:

1. Respondent shall issue licenses to petitioners herein as hereinafter provided for their respective radio stations located in the State of Washington.

2. Such licenses for the period from January 1, 1959 to the date of entry of the final order in the Marion proceeding (hereinafter referred to as "the interim period") shall be issued in either the annexed form of Washington Local Station Blanket Radio License (Exhibit "A") or in the annexed form of Washington Local Station Per Program Radio License (Exhibit "B"), in accordance with the election under paragraph 3 of this order, and petitioners shall pay license fees for such interim period at the rates provided in such respective forms of agreement.

3. Payment of such interim fees shall be made on the 20th day of the month following each month for which such interim fees are payable hereunder, provided that interim fees for the respective months of January through October, 1959 (the period prior to the filing of the petition herein) shall be paid concurrently with the license fees payable for the months of November, 1959 through August, 1960, respectively, that is, fees for the month of January, 1959, shall be paid concurrently with the fees payable for the month of November, 1959; fees for the month of February, 1959 shall be paid concurrently with the fees payable for the month of December, 1959, etc. The foregoing payments shall be accompanied by statements in the form pro-

vided in the respective agreements annexed hereto as Exhibits "A" and "B". Each petitioner shall indicate its election between the blanket and per program forms of agreement by the form in which it elects to submit its first accountings under the interim licenses provided for in this order and such election shall be binding on each petitioner and on the Society for the full term of such interim licenses.

4. The licenses required to be issued hereunder shall continue in the form of Exhibits "A" and "B", respectively, until the entry of the final order in the Marion proceeding, and thereupon such licenses shall be deemed modified to conform in every respect with the corresponding agreements (including any documents made a part thereof) approved in the Marion proceeding, except that the last three numbered paragraphs of each of said Exhibits "A" and "B" shall not be changed and their respective terms shall be from January 1, 1959 through December 31, 1963. Respondent shall mail copies of such modified agreements to petitioners within a reasonable time after entry of such final order. Within fifteen (15) days after receipt of such copies, petitioners may sign and return either the Washington Local Station Blanket Radio License or the Washington Local Station Per Program Radio License, at the option of the respective petitioners, for execution by respondent.

5. Upon the entry of the final order in the Marion proceeding, the license fees paid hereunder for the interim period shall be adjusted retroactively to January 1, 1959 on the basis of the appropriate final form of agreement referred to in the preceding paragraph.

6. Taking into consideration the provisions of the Amended Final Judgment herein, the regulation of the activities of the respondent thereunder and the scope of its activities pursuant thereto, and giving due regard to the enactment of Revised Code of Washington, C.19.24—Laws of 1937, c. 218, the licenses which the Society is hereby directed to issue may lawfully be entered into between respondent and petitioners, and respondent is hereby directed to enter into such license agreements with each of the petitioners.

7. The provisions in said agreements for the disposition of claims for the period prior to January 1, 1959 are reasonable and do not discriminate against other users in the State of Washington or in other states.

Dated: New York, New York
November 20, 1959.

/s/ Sylvester J. Ryan
Chief Judge

We consent to the entry of
the foregoing order

November 20, 1959

/s/ Ronald A. Murphy
Attorney for Petitioners

/s/ Herman Finkelstein

/s/ Schwartz & Frohlich
Attorneys for Respondent